NEW YORK CITY PENSION PLAN INVESTMENTS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

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SECOND SESSION

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NEW YORK CITY PENSION PLAN INVESTMENTS

TUESDAY, MARCH 7, 1978

U.S. SENATE,
SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m. in room 2221, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the subcommittee) presiding.

Present: Senators Bentsen, Byrd, Jr., of Virginia, Moynihan, and Curtis.

[The committee press release announcing these hearings follows:]

PRESS RELEASE

FINANCE SUBCOMMITTEE ON PRIVATE PENSION PLANS AND EMPLOYEE FRINGE BENEFITS SETS OVERSIGHT HEARINGS ON INVESTMENT OF THE NEW YORK CITY PENSION FUNDS

Senator Lloyd Bentsen (D.-Tex.), Chairman of the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Senate Committee on Finance, announced today that the Subcommittee will hold oversight hearings on March 7 and 8, 1978 on the investment of the New York City pension funds.

The hearings will be held in Room 2221 Dirksen Senate Office Building and will begin at 10 a.m. on both days.

Witnesses who desire to testify at the hearings should submit a written request to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510 by no later than the close of business on March 1, 1978.

Legislative Reorganization Act.—Senator Bentsen stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) A copy of the statement must be filed by noon the day before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 75 copies must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses are not to read their written statements to the Committee, but are to confine their fifteen minute oral presentations to a summary of the points included in the statement.

(5) Not more than 15 minutes will be allowed for oral presentation.

Written Testimony.—Senator Bentsen stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by March 31, 1978, to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510.

Senator BENTSEN. These hearings will come to order.

I would like to say at the beginning of these hearings that Senator Moynihan wanted very much to be here at the start of the hearing but had a longstanding commitment that precluded his being here but will attend as soon as he is able to do so. In addition to that, Senator Javits of New York will be in attendance this morning. He is a very interested participant.

This morning, the Pension Subcommittee of the Senate Finance Committee begins its oversight hearings on the investment of assets in the New York City pension funds. Two years ago, the Senate approved legislation, Public Law 94-236, which temporarily exempts New York City employees' pension funds from certain longstanding fiduciary obligations of the Internal Revenue Code.

I am deeply concerned that this law has been abused in such a manner as to circumvent the necessity for New York City to balance its budget in accordance with generally accepted acounting standards. I am deeply concerned that the favorable tax treatment granted by the Senate has enabled certain municipal officials in New York City to engage in clear conflicts of interest.

I read in some of the New York papers that there is an implicit understanding that if these pension funds buy additional New York City obligations that, in turn, ought to be able to get them a higher wage contract. That has to be a conflict of interest between retired employees and employees currently on the payroll. You find those trustees trying to serve two masters.

That kind of conflict of interest ought to be halted immediately.

Yesterday I released a study prepared by the Library of Congress which documents that the balanced budget requirement of the November 1975 New York City pension agreement was quietly deleted through the enactment of a substitute New York City pension agreement in August of 1977 which does not include the balanced budget requirement.

The 1977 substitute was drafted by the largest New York City banks and the municipal union.

After my opening statement, I shall insert a copy of the Library of Congress study.

The achievement of a balanced budget in New York City would clearly facilitate the marketability of New York City obligations. This would help insure that the New York City obligations held by the pension funds would be saleable and able to pay for promised reretirement benefits.

During these hearings, we will attempt to determine why the balanced budget clause was removed from the pension fund agreement. Furthermore, we will determine whether other aspects of the 1977 substitute agreement violated provisions of Public Law 94-236 so as to raise questions about continued favorable tax treatment for these pension funds.

By June 30, 1978, about 35 percent of the assets in the New York City pension funds will be invested in New York City obligations, or debt of the Municipal Assistance Corporation. In comparison, public pension funds across this country average about 3 percent of their assets in State and local government securities.

From the point of view of sound investment policy or sound pension policy, such concentration is clearly imprudent and clearly jeopardizes the interests of retirees and beneficiaries.

With respect to pension policy, no manager would concentrate investments to such an extent even in the best of blue chip stocks.

Furthermore, New York City's notes and bonds are really not the best security in the marketplace today.

Some of the leading banks in the country, such as Chemical Bank and Wells Fargo Bank, advise against investing more than 5 percent of a pension fund in just one security, yet the New York City pension funds have invested 35 percent of the assets in securities of New York City or MAC.

There also appears to be a very serious conflict of interest with respect to the investment of the assets of the New York City employee pension fund.

That is the situation I discussed of the pension trustees being the the same individuals who negotiate the labor contracts on behalf of the municipal employee unions.

However, the interests of those retired employees and the interests of the current employees can be totally opposite.

To the extent pension funds are tapped in order to help New York City through its immediate financial crisis, there is less need for the city to reduce unnecessary municipal jobs or reject excessive wage and fringe benefit demands.

Union officials have to choose between the interests of retirees and active workers.

It must be noted that pension beneficiaries receive favorable tax treatment from the tax writing committees of the Congress. Pension plan participants receive certain income tax exclusions, estate and gift tax exclusions and special lump sum distribution treatment.

With respect to private pension plans, this committee has imposed some very strict standards against conflicts of interest in the 1974 Pension Reform Act. The question is why we should not do so on public pensions.

[The following was subsequently supplied for the record:]

THE LIBRARY OF CONGRESS,
CONGRESSIONAL RESEARCH SERVICE,
Washington, D.C., March 3, 1978.

To: The Honorable Lloyd Bentsen, Attention: David Allen.
From: Economics Division.
Subject: Requirements for New York City to balance its budget contained in the Amended and Restated Agreement of November 26, 1975 and the First Amendment to the Amended and Restated Agreement of November 26, 1975.

In November 1975, the New York State Emergency Financial Control Board, a State board created to oversee New York City's progress toward attaining financial stability, approved a three year plan for balancing the city's budget by June 30, 1978. The complex package of taxes and debt rescheduling included an agreement with the New York City employee pension funds for the funds to purchase $2.5 billion of new Municipal Assistance Corporation (MAC) or city securities through June 30, 1978.

The agreement[1] stated that the obligations were subject to the fulfillment of certain conditions, including:

At the time of any exchange, renewal or purchase of such short-term notes or renewal of City Notes hereunder the Mayor and the Comptroller of the City of

[1] Amended and Restated Agreement of November 26, 1975.

New York and the New York State Emergency Financial Control Board if such Board is then in existence shall have certified that the budget of New York City for the fiscal year of New York City in which such exchange, renewal or purchase occurs is balanced . . .

The agreement further states that if any of the conditions are not satisfied, "any City Notes retained" under this section "may be presented for payment in full."

On August 17, 1977, MAC and the parties to the Amended and Restated Agreement of November 26, 1975 executed the First Amendment to the Amended and Restated Agreement of November 26, 1975. There is no language in the First Amendment requiring that New York City achieve a balanced budget.

STACEY M. KEAN,
Analyst in Government Finance.

Senator BENTSON. Our first witness this morning is Congressman John Erlenborn, the ranking Republican on the House Labor Subcommittee and the House Pension Task Force. He is one of the leading authorities on private and public pension systems.

I recall the many hours of debate and work we did together on the pension guarantee conference, and that is another subject we will talk about at another time, Congressman. We are delighted to have you this morning.

STATEMENT OF HON. JOHN N. ERLENBORN, A UNITED STATES REPRESENTATIVE FROM THE STATE OF ILLINOIS

Representative ERLENBORN. Thank you very much, Mr. Chairman.

Accompanying me is Mr. Russell Mueller, actuary and minority legislative associate on the House Pension Task Force.

Mr. Chairman, I thank you for the opportunity of appearing before you to discuss the investment of New York public pension funds in city and MAC bonds.

For the record, let me state that I am the ranking minority member of the House Committee on Education and Labor's Subcommittee on Labor Standards. That is the committee that also is the parent of the Pension Task Force.

I have been a member of the Education and Labor Committee for nearly 13 years.

Because of my position on the subcommittee, I was deeply involved in the drafting of the Employee Retirement Income Security Act (ERISA), which sets requirements for reporting and disclosure for private pension plans. It also sets standards for fiduciaries, vesting, funding, and participation of employees; and insures participants' benefits in case of plan termination. ERISA applies mainly to pension plans in the private sector; it has little effect on plans covering public employees.

Public pension plans are controlled only by certain sections of the Internal Revenue Code. For example, section 401(a) deals with the "exclusive benefit rule" which says that the pension funds must be managed for the exclusive benefit of the plan participants and beneficiaries.

Public Law 94-236, as you know, which we are discussing here today specifically exempted New York pension trustees from sections 401(a) and 503(b). They are allowed, even urged, to buy New York paper for their funds without regard to whether or not the pension administrators thought it was in the best interest of the participants.

Passage of Public Law 94–236 was, in my opinion, a mistake in the first place and one which ought not be repeated. New York City pension plans, like most other public plans, are contributory; that is, the employees have a certain amount of money taken out of their paychecks to put into their retirement fund. The city also contributes to this fund which, of course, is money it gets from all city taxpayers.

Extending 94–236 will allow city officials to play a game of "Monopoly" with real money. It is the real money of the employees and the taxpayers of the city. The amount withheld from the employees would otherwise be used to make house payments, buy groceries, or send the kids to college.

If those funds are used as the prime source of money to run the city, the pension plans will be forced into a position where their financial health is totally dependent upon the financial condition of the city. Which of us would deliberately place our own constituents private pension funds in such jeopardy?

If a major utility came before this body and asked that the employees' pension fund be used to purchase several billion dollars worth of that company's bonds so that it could upgrade its equipment, I suspect there would be little sympathy for the company.

The administration is suggesting the same thing for the city of New York. We should extend the same level of sympathy.

The exclusive benefit rule in section 401(a) is the basic foundation for laws covering the use of any pension funds. Funds which violate that section are liable to lose their tax-exempt status.

ERISA was passed to further guarantee this protection to private workers.

Under the terms of ERISA a private pension fund may not invest more than 10 percent of its assets in the company or companies for which the plan participants work.

Public plans do not fall under ERISA but if ever there was a good argument for extending the law to them, the high percentage of public plan assets in New York paper is it.

The Pension Task Force of the House Committee on Education and Labor will be issuing a report shortly which, we think, is the first comprehensive survey of the condition of public pension plans in the country.

As reported last fall, 96 percent of public employees covered by some 7,000 public employment retirement plans were included in the survey. The plans of State and local governments have assets in excess of $115 billion. These plans cover some 13 million participants.

It is obvious that the amounts of money involved can make the plans easy targets for politicians who need access to cash to run their communities.

The task force's research shows that the New York City pension funds have done an overall better job of funding their liabilities than have many other public pension funds. But this is faint praise, because the report will further show that the overwhelming majority of public pension plans are following contributing practices which leave them considerably short of full actuarial funding.

The report will also show a general lack of accountability of public pension plan fiduciaries and a general lack of fiduciary standards among the public plans. This lack of standards has led to violations of

the Internal Revenue Code and to imprudent investments by plan administrators in their own government securities, which are generally tax exempt and of lower yield than other investments.

There has been an uneven enforcement on the part of the Internal Revenue Service with respect to these investments, leading me to believe that the New York pension funds are an indication of a wider problem and ought to be considered in that wider context.

It will be shown that many of the conditions that existed in the private sector leading to the enactment of ERISA also exist in the public plans.

For instance, 60 to 70 percent of State and local plans do not disclose, or do not even know, the market value of their own plan assets. It appears that public pension plans are not operating within the generally accepted financial and accounting standards applicable to private plans.

Again, I cite these points to demonstrate the necessity of keeping in mind that there are many thousands of public pension plans and many million of public employees outside of the city of New York. Many of these plans and employees are facing the same pressures as the plans we are discussing here today.

The trustees of public pension funds must be subject to the same standards and guidelines as trustees of private plans with respect to self-dealing and accountability. They should fall under the same requirements for disclosure, reporting, and party and interest loans. The participants should be informed as to the benefits they can expect and the financial condition of their plans. The trustees should fall under the same rules of prudent man, diversification, and exclusive benefit.

Although a speculator might find city or BIG MAC bonds an interesting investment, a prudent man would not buy 15 cents worth of that paper. City paper is not salable in the private market because of New York's continued inability to balance its budget. That paper is, nonetheless, being held in huge quantities by the public pension funds, and they are being asked to buy more.

Saddling these funds with an even larger amount is clearly not to the exclusive benefit of the plan participants. It is clearly not a prudent investment; it is clearly wrong.

If anything, we should be moving toward reducing the amount of pension fund money tied up in the employer's bonds in general and New York paper in particular.

Under ERISA, we allowed a transition period for private funds to get their percentage of assets in the employee's company down to the 10-percent level. Obviously, demanding that the city pension plans dump the paper they have in their portfolios would not be a prudent move. Forcing them to increase that percentage is even less prudent.

The public pension plans should not be forced to act as the bank of last resort for any State or municipality which finds itself in financial difficulty.

Jack Bigel, consultant to trustees of city pension funds and Ellmore C. Patterson, chairman of the executive committee of the Morgan Guaranty Trust Co. told a House subcommittee last week that New York banks and pension funds could probably not loan New York more money without violating their fiduciary responsibilities to safe-

guard other people's money unless the Federal Government guarantees repayment.

A Federal guarantee of New York City securities might make them a prudent investment, depending upon the nature of the guarantee and the interest on the bonds. But by providing that guarantee, and an exemption from the exclusive benefit rule, we are forcing the pension funds into a situation where they will be forever subject to "political blackmail."

As larger and larger percentages of their assets are tied up in New York securities, the very existence of the funds will become tied to the state of financial health of the city. They will fall ever easier prey to the whims of politicians.

The employee pension funds in New York have about 35 percent of their assets tied up in city paper at the present time. Increasing this amount puts the employees in the position of being forced to use their own money to guarantee the finances of the city.

The motorman on the "A" train might find it in his best interests to get out at the Wall Street stop and check on the financial condition of the city before turning his train around to head back uptown.

A Federal guarantee poses a further risk. If the public pension funds in New York purchase additional New York paper at the prodding of this administration, does not the Federal Government assume the role of fiduciary for the pension plans?

A Federal guarantee would be tantamount to the Government being placed in the position of not only guaranteeing the bonds that the plans purchased, but also guaranteeing the benefits that the participants are to receive.

It is clear that if the Federal Government is going to place itself on the position of providing plan termination or insolvency insurance, it ought to have the benefits of proper reporting and disclosure procedures as well as fiduciary standards.

The pension fund administrators, acting as fiduciaries, might well agree to purchase additional bonds based upon a Federal guarantee, but they might and probably should hold out for more. It would be within an administrator's fiduciary responsibilities to say, in effect, we will buy the additional paper, but only if the Federal Government agrees to guarantee the bonds we bought previously.

That line of thinking would certainly place the Federal Government in the position of providing plan termination or insolvency insurance.

Mr. Chairman, Public Law 94-236 should be allowed to die. We should not place the pension funds of public employees of New York City or anywhere else at risk. We should, rather, begin instituting practices which would cause those funds to be less closely tied to their employer's financial condition.

If New York City pension funds had never been allowed to hold more than 10 percent of their assets in city paper, we would not be considering this action today.

We must not consider New York in a vacuum. Overall standards must apply in the dealings of public pension funds. Today it is New York City which is in financial difficulty. Tomorrow it could be Chicago, Ill., Brazoria County, Tex., or even Atlanta, Ga.

We must consider the precedents we are being asked to set with respect to all public pension funds. Those funds, like private funds,

should be managed for the exclusive benefit of participants, not for the benefit of the Congress of the United States or of the administration of the city of New York.

In short, Mr. Chairman, it is not our money to play with. Thank you.

Senator BENTSEN. Thank you, Congressman.

Congressman, we were commenting earlier that we were conferees on the Pension Reform Act of 1974 and I recall at that time that we were told that on multiemployer plans, that we had no real likelihood of any bankruptcy there and we had great safety in those plans if we would guarantee them. We have found them to be, many of them, in extremely poor shape.

In fact, the Pension Guaranty Corporation may be faced with a liability of several billion dollars. Both your subcommittee and mine are now currently reviewing that, trying to find out what we are going to do about it.

However, I think we learned a lesson about pension guarantees, that they can be very expensive to the Federal Government, whether we are talking about a bituminous coal plan or a New York City plan.

Are we not talking about essentially a very big cost to the American taxpayers with respect to New York City pensions?

Representative ERLENBORN. Certainly, we are. As I say, if we guarantee these bonds, we are really ultimately guaranteeing the benefits of the participants. If we, through action of this administration and this Congress, put pressure on the administrators of the New York City plans to buy these assets, then we are not only guaranteeing those assets, I think we are ultimately going to guarantee the benefits that participants are entitled to.

If we do that for New York City, we must do that, I think, for all public plans. This really is, I think, the first rather timid step, but the first step toward public plan termination insurance.

And, as you suggest, we should have learned our lesson from ERISA. You may recall one of the very first applicants for benefits of plan termination for the multiemployer fund, while it was discretionary, as it still is, was the anthracite coal fund, and the study by PBGC last year about the multiemployer funds led them to believe that if the mandatory insurance took effect as of January 1 of this year, as it was scheduled to under ERISA, it would have precipitated the termination of many of the multiemployer plans and would have brought several billions of dollars of liabilities on PBGC.

And, as you recall, we had to respond to that by extending, in a rather emergency fashion, the time for the imposition of mandatory insurance in the multiemployer field. We did pass a bill in the closing days of the last session to extend that time so that it still is a discretionary coverage.

But that would be, I am afraid, peanuts to what we are talking about here in the public plan area.

Senator BENTSEN. When we passed ERISA in 1974 we put in some very strict requirements on funding and on fiduciary responsibilities. Do you not think a guarantee for New York City pensions would call for just such requirements?

Representative ERLENBORN. Absolutely.

I would say, Senator, whether we guarantee those bonds or not, this Congress should be looking right now very seriously at the question of whether we ought not to require all public plans to report, to disclose to the participants the terms of the plan; to disclose to participants their rights in the plan; and also to impose fiduciary standards.

Our study, when it is issued, will show that the law relative to the various public plans throughout the country is a chaotic condition. In many areas, there are no standards of fiduciary conduct that can guide the fiduciaries in the public plans and many have not even had their plans audited for many years. They do not even know the value of their own assets.

Senator BENTSEN. Congressman Erlenborn, we are very appreciative of your testimony and it will be very helpful to us in our considerations.

Representative ERLENBORN. Thank you very much.

Senator BENTSEN. We are pleased to have with us this morning the Secretary of the Treasury, Secretary Blumenthal.

Secretary BLUMENTHAL. Good morning, Mr. Chairman.

Senator BENTSEN. Good morning.

Whenever you are ready, Mr. Secretary.

Secretary BLUMENTHAL. Yes; I am, Mr. Chairman.

STATEMENT OF HON. W. MICHAEL BLUMENTHAL, SECRETARY OF THE TREASURY

Secretary BLUMENTHAL. Mr. Chairman, I appreciate the opportunity to appear before this committee and to review with you the experience under Public Law 94–236 as well as to refer to the proposal which the administration has just made for finalizing, hopefully once and for all, Federal assistance to bring the city of New York back to financial stability and true budget balance.

I have a prepared statement which, with your permission, I would like to submit for the record. I will not read it. I would like to make some general comments about it.

Senator BENTSEN. Yes; we would be very pleased to have it, Mr. Secretary.

Secretary BLUMENTHAL. Mr. Chairman, Public Law 94–236 has made possible the participation of the city pension funds in New York City's financial arrangements for the past 3 years. The funds will have bought over $2.5 billion for city bonds by June 30, 1978. Indeed, as of June 30 of this year, we estimate that the city pension funds will own about $3.5 billion of city and MAC debt out of total assets of about $10 billion; therefore, roughly 35 percent of their total assets will be held in city or MAC paper.

Public Law 94–236 was necessary in order to maintain the qualified status for these funds, in particular as regards sections 503 and 401 of the Internal Revenue Code which deal with prohibited transactions on the one hand and the exclusive benefit provision on the other.

I think it is safe to say, Mr. Chairman, that if it had not been possible for the funds to invest in city of New York and MAC paper, then the city would have gone into default. That is the genesis of Public Law 94–236. I will not go into a description of exactly what it provides; I think that is well understood.

I have attached a table, table 1, to my testimony which shows the assets of each fund and the amount of city and MAC securities that, we estimate, will be held as of June 30 of this year.

I think, Mr. Chairman, I want to hasten to underline the fact that we are not dealing with a normal situation here at all. Nor do I think that what has been done in the case of New York City and what the administration proposes be done over the next 4 years should be considered in any way to be a precedent for other cities or municipalities throughout the country.

I think the case of New York City is extraordinary. It is the only major city that, in fact, did lose its credit, was shut out from the credit market. It is the largest city in the country. It is the financial center of the world. The impact of a default of New York City in my judgment, on even our international situation, on the stability of the dollar, the way in which other people view us, I think would be quite serious.

You well know the difficulties that we are experiencing at the moment in foreign exchange markets. In my judgment, amongst the many reasons why that has been an increasing problem, one of the important ones has been the dismay on the part of many foreign observers of our inability to take action on the energy front, to pass energy legislation. The recognition that it has been almost a year since the President made his proposals and still we have not yet taken action.

That leads to the question of whether or not the United States has the will to act on an important national problem.

It seems to me that if we allow the city of New York to go into default, to go bankrupt, in the minds of many people, this being the financial center of the world, that same question will arise. Why is it that the United States does not have the capability and the will to deal with an important financial problem short of bankruptcy and default?

I think, more importantly, however, the consequences of that situation would need to be clearly borne in mind, Mr. Chairman.

Let us assume that Public Law 94–236 were not extended. In that case, the present bonds that are held by the city pension funds would go into default, because the funds' inability to participate in a new financing plan would make it impossible for the city to obtain the financing it needs. Without further aid from the funds, the city's bankruptcy would seem assured, leading to default on bonds already held.

That would mean that we would be interrupting what is, essentially, a workout situation that the city has embarked on in the last few years and that we, in our proposal, are recommending be completed over the next 4 years.

If those securities go into default, then the financial viability of those funds is really in doubt, and many of the present and future beneficiaries would not be paid. I think that is a practical reality which I think we have to recognize.

I do not see how the funding of the debt of the city of New York can be carried on, with or without Federal guarantees, even if the Congress does not approve of the plan which we have proposed, without participation by the pension funds. Without that, there will almost

certainly be default. When that happens, the present notes held by the city would not be paid, and that would automatically trigger, like a self-fulfilling prophecy, the crisis of the funds.

Second, it would certainly mean that the city could not continue to make further contributions to the funds, which would raise problems for present employees of the city who are now working and who expect to receive the benefits to which they are entitled under their pension plan.

Third, there would, of course, be a loss of jobs and that would work to the disadvantage of the beneficiaries of the pension funds.

So, I think all of this makes it clear, first that bankruptcy is not the answer. Second, that bankruptcy can only be avoided if, for a period of time that was begun 3 years ago and that we are recommending be allowed to continue for the next 4 years, the city pension funds be involved in purchasing city and MAC bonds.

Now, the next point that I wish to stress, Mr. Chairman, is that the particular proposal that we have made is, I think, based on the recognition that the situation has improved greatly, that the city has substantially met the obligations that it assumed in 1975 at a very difficult time to get itself out of what was a very messy and unfortunate situation.

The budget has been "balanced" according to State law—I put that "balanced" in quotation marks; it has not been truly balanced, but it has met those obligations. We now have a plan and I have submitted a copy to the committee of the testimony I gave before a House subcommittee on the question—a plan under which it will achieve true balance according to generally accepted accounting principles by the end of the fourth year.

[The following was subsequently supplied for the record:]

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL, SECRETARY OF THE TREASURY

Mr. Chairman and members of this distinguished Subcommittee, I appear before you to present the Administration's recommendations on the future federal relationship to the financing of New York City. My testimony will cover three major areas: first, the events of the past two and a half years which underlie our discussions here today; second, New York City's budget and financing plans covering the 1979–1982 period; and third, the Administration's recommendations on financing assistance for the City during that period.

Mr. Chairman, four important principles underlie the conclusions which I will present today.

Preserving New York City's solvency: This Administration believes that the effects of a bankruptcy on the residents of the City and State, and elsewhere, would be very serious. A concerted effort must be made to prevent bankruptcy.

Maximum budget and financing efforts by the local parties: Primary responsibility for New York City's financing rests with the local elected officials and the relevant private parties at the City level. Beyond that, the City is the responsibility of New York State. Any federal financing role should be provided only under extraordinary circumstances and should be limited to a residual and temporary one.

A truly balanced city budget is a prerequisite to ending this crisis: New York City lost access to conventional borrowing sources because it incurred large budget deficits and otherwise lost control of its finances. These deficits have been reduced, but not eliminated, and they remain the primary obstacle to restoring the City's access to the credit markets. Any post-June 1978 financing plan, therefore, must be conditioned upon achievement over the plan period of a budget which is balanced in accordance with generally accepted accounting principles.

The New York City financing crisis should be resolved once and for all: The only acceptable plan for future financing of the City is one which will restore New York's ability to finance itself.

Mr. Chairman, let me now begin a detailed discussion of the past and present situation and our legislative recommendations for the future.

I. REVIEW OF THE 1975–1978 PERIOD

During the early 1970's, New York City's fiscal condition was weakened by the migration of jobs and related tax revenue from the City, the 1974–1975 national recession as well as unsound budget and borrowing practices.

The consequences of these became clear in early 1975, when the municipal bond market closed to New York City, and the City teetered on the edge of bankruptcy. The City's then budget of approximately $13 billion—by far the largest municipal budget in this country—was estimated to be $1.8 billion in deficit, and its accounting and financial control systems were archaic and unreliable.

Not only did the public markets close to New York City, but even massive efforts in 1975 by the State of New York were insufficient to solve the entire City financing problem. The State created a Municipal Assistance Corporation (MAC), with authority to issue its own bonds, and to use the proceeds for making direct loans to the City and refinancing its notes. The State also advanced $800 million of additional funds directly to the City. Yet, MAC was unable to borrow sufficient amounts in relation to the City's needs. Indeed, in the fall of 1975, the municipal bond market also closed to MAC, and the State was forced to take further action. It installed an Emergency Financial Control Board (EFCB) to exercise substantial control over the City's finances.

These drastic steps were still insufficient, however, and imminent bankruptcy threatened. In that context the Congress passed the 1975 New York City Seasonal Financing Act. This legislation authorized the U.S. Treasury to provide short-term loans to the City to meet cash flow imbalances occurring within the City's fiscal year. These loans were purely seasonal—they were extended and matured within the City's fiscal year—and were limited to $2.3 billion in any one year. This federal lending program, which expires in less than four months, has supplied New York City's short-term borrowing requirements since late 1975.

From 1975 through June 30, 1978, the City's employee pension funds will have purchased $2.65 billion of long-term City and MAC bonds, bringing their total holdings of such debt to 35 percent of their total assets. Such purchases have satisfied New York's long-term borrowing needs during this emergency period.

The 1976–78 period

Mr. Chairman, both the 1975 emergency State legislation and the Seasonal Financing Act required New York City to adhere to the three-year financial plan developed in 1975 and to take a series of other steps to improve its fiscal condition. These were designed to restore the City's access to conventional borrowing sources.

A crucial aspect of today's discussion, then, concerns these steps—whether they have been taken and whether they were sufficient. As to the first point, Mr. Chairman, it is clear that New York City has done what it pledged to do in 1975. Let me quickly review the major steps taken, particularly because many here in Washington and elsewhere may be under the misapprehension that the New York City fiscal condition has not improved since 1975.

The City's real budget deficit has been reduced from approximately $1.8 billion in fiscal 1975 to approximately $760 million in 1978.

Its work force was reduced substantially. The current level of City employment, at approximately 300,000, involves 60,000 fewer jobs than in early 1975.

More than $3 billion of short-term City notes, which were oustanding in mid-1975, were converted into long term MAC bonds.

For the first time, tuition payments covering all students were initiated at City College.

A $16 million management information and expense control system (IFMS) has been installed and is working.

The City has engaged in a consortium of certified public accountants—led by Peat, Marwick, Mitchell & Co.—to conduct an independent audit of its current year's results. Most municipalities are not audited by independent, private accountants.

Table 1 provides more detailed information on City budget trends during the past three years.

New York State also has taken steps to help. As I mentioned earlier, it now advances $800 million annually, to finance a cash shortfall. It now funds 75% of the costs of the City University senior colleges and is assuming funding responsibility for the City's court system. Through the Emergency Financial Control Board, it oversees the City's budgets and borrowings. Moreover, Governor Carey provided invaluable personal leadership during the height of the 1975 crisis and has continued to do so.

City seasonal borrowings from the Treasury

The City has complied with all key provisions of the Federal seasonal loan program. Furthermore, the program has not cost the U.S. taxpayer anything. Table 2 provides a schedule of our total loans under the program.

During fiscal year 1976, New York borrowed $1.26 billion and repaid it with interest, either on time or ahead of schedule. In fiscal 1977, $2.1 billion was borrowed and again repaid punctually. During this current year, the City has borrowed $1.875 billion, and I anticipate timely repayment of the full amount.

Under the law, Treasury is required to charge the City one percent more than the rate on outstanding U.S. Government obligations of comparable maturity. As a result, this year's seasonal loan program will yield a net surplus of approximately $13 million. This amount will be returned, of course, to Treasury's general fund. The aggregate amount of interest received by the Treasury during the three-year period, over and above our borrowing costs, is $30 million.

II. NEW YORK CITY'S CONTINUING LACK OF ACCESS TO CONVENTIONAL LENDING SOURCES

Although New York City has taken the important steps I have outlined, the municipal credit markets have not re-opened to the City. At the moment, its notes and bonds remain unsalable in the public markets. A primary purpose of the Seasonal Financing Act—to restore New York's access to conventional lending sources—has not been achieved.

I am satisfied that New York has made every effort to test the public markets for its notes, as required by its Credit Agreement with the Treasury. Thus in November, 1977, after three months of preparation, New York attempted a $200–$300 million public note offering. Unfortunately, the notes received a discouragingly low credit rating, and buyers could not be found for them.

There are at least two reasons for this lack of market access. The first concerns continuing budget deficits. To the extent that budget deficits originally caused the City's loss of market access, New York's smaller but continuing deficits remain a primary obstacle to regaining it.

The second reason for New York's continuing lack of market access might be described as traditional investor skepticism. Once a major borrower—municipal or corporate—loses his credit standing and is nearly insolvent, the rating agencies and the public markets require a period of years before they are convinced that corrective steps have worked and that creditworthiness has been restored. This is a natural lag, and there are numerous examples of it in modern finance. The public financing difficulties of our airline industry, after its loss years of the early 1970's, are a representative example.

It is not altogether surprising, therefore, that the credit markets did not re-open this year to New York. It is only two and a half years since the height of its fiscal crisis and its near bankruptcy. Market access generally isn't regained that fast. The traditional skepticism of public markets is such that New York needs more time before it can rely on those markets for the full amounts of its borrowing needs.

III. THE CITY'S FOUR-YEAR BUDGET OUTLOOK

Most informed observers believe—and I concur in their conclusion—that if the obstacle of budget deficits could be eliminated, then investor caution would tend to dissipate. Accordingly, I asked City officials in November to prepare a four-year financial plan, covering budgets and financing, and aimed at achieving balance in accordance with generally accepted accounting principles at the end of the plan period.

Treasury received this financial plan on January 20, and has been reviewing it since then, together with our consultants—Arthur Andersen & Co. I will now discuss the City's current budget condition, this budget plan and our assessment of it.

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Parameters of the city's budget

New York does not have a conventional budget and cannot eliminate these deficits in one year. Let me explain why.

New York City's budget is virtually unique in terms of its size and composition. At approximately $14 billion today, it is by far the largest municipal budget in the United States. Indeed, New York has the third largest overall government budget in this country—behind the Federal government and the State of California, but considerably larger than that of New York State. This enormous City budget reflects New York's huge population (7.5 million) and the large number of services for which the City, instead of a larger county or state, pays for.

Specifically, the City administers a wide range of State and national welfare programs, for which it must pay a large share of the costs. The City pays for 25 percent of the welfare and medicaid benefits provided to its residents. These alone involve $1.2 billion each year. New York is the only major U.S. city responsible for paying this high a share of welfare and medicaid. Indeed, only 12 states require their localities to share any substantial amount of the costs of federal welfare programs.

In addition, the City funds a series of other services which, in other cities, are paid for by larger governmental units—a county or the state. This is partially because New York is so large, both in territory and population. It also reflects an historical division of financial responsibility whereby the City pays most of the costs of the municipal courts, hospitals, and public schools.

Lastly, New York's budget is unusually vulnerable to economic fluctuations. A higher proportion of its revenues are derived from economically sensitive taxes, e.g., sales and income taxes, than almost any other large U.S. city.

New York City—A reflection of America's urban problems

Apart from these special problems, of course, New York suffers from a series of ills which afflict many other urban centers. The City's economy has declined sharply during the past decade, as have those of numerous other northeast and Midwest cities. New York has lost approximately 510,000 jobs from 1969 through 1975, an amount which alone exceeds more than the total public and private employment of all but a handful of other cities. Moreover, the City faces a serious revenue/expenditure gap with revenues growing more slowly than inflation-driven expenditures.

These problems are not unique to New York. They are common to a number of our larger American cities. The underlying cause is largely one of secular economic decline. Current trends include population loss, declining private sector employment and slower per capita income growth.

Hence, the ability of the City to balance its budget over the four-year period is substantially impacted by the local and national economies. A declining local economy yields the equally unattractive choices of either raising taxes or cutting services. Each of these steps accelerates the deterioration of its economy. The only way to break the downward spiral is to rebuild the private sector base.

Cognizant of these problems, the Administration already has taken steps and plans further ones to assist declining cities. Upon taking office, we proposed the 1977 Economic Stimulus Package, which supported CETA and Countercyclical Revenue Sharing. These programs provide major fiscal assistance to cities. Through the proposed 1979 budget, the Administration plans to do more.

The Administration is committed to developing a comprehensive urban policy which will address the short-term and long-term needs of our cities. Toward this end, all Cabinet agencies have been involved in a wide-ranging analysis of existing urban programs and new initiatives. For instance, Treasury has focused on possible financing tools to improve the private sector investment base in stagnant and declining economies. Shortly, the President will announce his urban policy package, which will specifically address these problems.

In short, although New York City is unique, it does share some similar economic and fiscal problems with other major American cities. The Administration is working with the Congress, state and local governments and the private sector to respond to them.

The city's four-year budget plan

The City's four-year budget plan is summarized in Table 3. Please note that this is a "plan", not a four-year budget. No City or governmental unit, be it New

York City or the U.S. Government, can today formulate a detailed budget for 1980, let alone 1981 or 1982.

You will note that City officials began by extrapolating current trends in revenues and expenditures, and assuming no actions to change them. This beginning forecast also assumed, at my request, that those operating expenses remaining in the capital budget be phased into the operating budget over the plan period. In effect, this halves the remaining period permitted under State law eliminating this practice.

The New York City plan projects a budget deficit of $457 million next year. This deficit grows to just under $1 billion in the fourth year. The primary reason for this growth is the phasing out of $640 million of expenses from the capital budget, into the operating budget. Looking at it based on generally accepted accounting principles, which require that these operating expenses be shown in the operating budget immediately, the projected annual deficit in 1979 would be about $1 billion.

Essentially, the City projects that natural trends in revenues and expenditures over the next four years will neither improve nor worsen its budget condition. The projected 1979 deficit approximates $1 billion, and, if no new deficit-reduction actions were taken, would be only slightly lower in 1982.

The plan makes no provision for wage increases. Yet, most labor contracts involving the City expire between March 31 and June 30 of this year. City officials decided that it was inappropriate, on the eve of collective bargaining, to assume any particular settlement. Yet, New York forecasts must be evaluated in light of this treatment of future wage costs.

City-projected deficit reduction actions

Having forecasted these deficits, the City's plans describes in detail a set of City, State and Federal actions which would eliminate the deficit.

Concerning City actions, the plan outlines six steps to save $174 million next year and cumulatively save $544 million by 1982. Half of this expense reduction would result from a 10% attrition-related cut in the City work force over the four years. Table 4 provides detail on each of the City actions and the related savings.

Regarding State actions, the plan lists 20 different steps which could be taken eliminate the City's defiicit. Together, they would yield $430 million of budget relief for the City next year—and grow to $760 million by 1982. The plan does not call on the State to take all 20 steps, but rather provides a list from which to work with State officials. Table 5 lists these State actions.

Consistent with this approach, Governor Carey and the State legislative leaders recently agreed to support $200 million of increased budget relief next year. City officials believe that this amount will be sufficient, together with the City's own steps and federal actions, to achieve 1979 budget balance.

Finally, the plan lists 18 possible Federal actions which increase Federal aid during the next four years, resulting in potential budget savings to the City of $224 million in 1979, growing to $452 million by 1982. The plan does not call on the Federal Government to take all 18 actions, but rather provides a list of potential actions, some portion of which together with City and State actions, would be adequate to balance the City's budget. Table 6 sets forth these City-proposed Federal actions.

IV. TREASURY'S ASSESSMENT OF THE CITY'S BUDGET PLAN

We have studied this budegt plan carefully, together with Arthur Anderson & Co. We believe that the probable City budget deficits over the next four years will be somewhat larger than those projected by the City, unless further actions are taken to offset the cost of recently approved Board of Education wage increments, necessary increases in contributions to the Fireman's Pension Fund and projected deficits of the Health and Hospital Corporation. These potential increased costs could, in our view, range from $40 to $120 million annually over the next four years. We asked the City to provide specific actions to offset these potential additional costs, and expect to receive them shortly.

Concerning revenue estimates, we have concluded that New York's forecast is conservative. It calls for no growth at all during the next two years, and then modest increases in 1981 and 1982. The City's revenue forecasts during the past two years have been quite accurate.

Our overall assessment of the revenue and expenditure estimates in the Plan are that they are realistic if adjusted as I have discussed. The City has undertaken to outline specific deficit reduction steps to accommodate the adjustments.

City, State and Federal deficit reduction actions

To eliminate the projected deficits, the City has proposed six deficit reduction steps at the City level. More than half of the budget relief would result from a 10% attrition-related cut in the City's work force. Our judgment is that the savings projected from this action is attainable.

The three smaller items—tightened welfare eligibility, tightened use of medical services covered by medicaid and cost containment steps in the home services program—also appear realistic.

Completion of the remaining two steps, which involve major savings, is less clear. The City projects savings, ranging from $23 million in 1979 to $94 million in 1982, from improved cost control in its procurement program. The size of its procurement exepnditures—$1.8 billion in 1979—suggests that these savings are attainable, but we have not yet received details on the specific steps involved. Similarly, the plan envisions savings of $62 million in 1979, growing to $100 million in 1982, from unspecified "management improvements." We do not have full details on these specific steps and cannot yet judge the likelihood of the related savings.

In short, Mr. Chairman, we are largely, but not fully, satisfied with projections of expense savings from actions at the City level. We are awaiting more details about proposed changes in procurement and planned management improvements before arriving at a final conclusion.

State actions

Turning to State actions, we have concluded that the recently announced agreement between the Mayor and Governor on a $200 million of increased 1979 State aid—if approved by the State legislature—should provide sufficient fiscal assistance to meet the requirements of the City's plan for State aid. I have discussed the situation with the leaders of the State legislature and am encouraged that favorable legislative actions will be forthcoming.

The second crucial question concerning State aid, however, concerns the 1980, 1981 and 1982 City budgets. The City probably cannot attain balance in those years unless the $200 million increase in 1979 State aid is both recurring and increased.

I have met with Governor Carey and the State legislative leaders and emphasized the need for increased recurring aid to the City. The Governor has provided estimates of increased aid in the 1980–1982 period. Generally, these amounts should be sufficient to help balance the City budget in those years.

I recognize that the State legislature cannot commit in advance to specific amounts in future budgets. Yet, it is also clear that increased State aid beyond 1979 is a prerequisite to achieving true budget balance for the City. Our position is that amounts of at least this magnitude must be provided.

Federal actions

The City's plan for closing the deficit assumes moderate additional federal fiscal assistance in 1979 and larger amounts in subsequent years. Our general view is that the City has primary responsibility for its budget, and beyond that, the State has the principal responsibility. Nevertheless, the City's needs are such that some federal residual budget assistance is clearly justified.

Table 7 summarizes the history of federal aid to the City in recent years and illustrates that New York has received growing amounts of federal aid in these years. I do not believe it is unreasonable to assume, that New York together with other cities will receive increases in federal aid over the 1979–1982 period as the President's urban initiatives are implemented.

City wage negotiations

One over-riding uncertainty in the City's budget plan involves the expiring City labor contracts. Most of these contracts expire between March 31 and June 30. The union leaders are seeking wage increases, while Mayor Koch is asserting the City cannot afford increases. The outcome may not be clear for several weeks or longer.

It would be difficult to overestimate the importance of these wage negotiations for the City budget plan. Each 1% increase in wages would increase over-

all City expenditures by $41 imillion, and this increase would be cumulative. Obviously, even a settlement involving small percentage increases could widen the projected budget deficits by 50% or more. The soundness of New York's budget plan, therefore, depends on the outcome of those negotiations.

While any wage settlement is a matter for negotiation between the City and its work force, our general position is clear, namely that any increases will have to be funded from productivity or related savings. We feel that is essential to a credible budget plan. As I stated earlier such a plan is an explicit condition to the Administration's legislative recommendations which I am presenting today. We do not favor the extension of any lending assistance to New York except on the basis of such a plan.

We will await the outcome of these negotiations, therefore, reserving final judgment on the City budget plan until they are completed. If there is any wage increase, the City must present a convincing, supplemental plan for offsetting its budget effects.

Let me note, Mr. Chairman, that I have discussed this on several occasions with the City labor leaders. They have provided real and responsible leadership during the past three years and recognize the need for wage restraint in 1979. I think that they and their members will exercise it.

V. NEW YORK CITY'S FINANCING OUTLOOK

Let me now discuss New York's borrowing needs.

Why New York borrows large amounts each year

Each year New York borrows large amounts through the issuance of both short and long-term notes. During this current year, for example, it has borrowed $1.875 billion on a seasonal basis and will have borrowed $1 billion on a 15-year basis.

Seasonal needs arise because City expenditures are spread fairly evenly over the year while certain revenues, particularly State aid, are concentrated in the final months of the City's fiscal year. The City thus borrows during the first months of its fiscal year, in anticipation of revenues to be received during the final months of its fiscal year.

New York, like all other municipalities, also must finance its capital budget. The City's capital budget includes expenditures for long-term assets, e.g. schools, roads, etc., that are traditionally financed with long-term debt. During each of the past two years, the City has sold $1 billion of long-term bonds to cover both traditional capital spending and operating expenses carried in the capital budget.

Recent financing history and current problems

Since 1975, substantially all of the City's new borrowing needs have been satisfied from two sources. Treasury has provided short-term loans under the Seasonal Financing Act, and the City employee pension funds will have lent $2.65 billion of long-term loans during the intervening two and a half years.

Both the Federal seasonal loan program and the union pension fund loan program expire on June 30, 1978. The City thus must develop new financing arrangements for both its short and long-term needs.

For this reason, I asked the City last November to develop an overall financing plan, to accompany its budget plan. This also was submitted to me on January 20, and Treasury has been evaluating it since then.

The city's 4-year financing plan

Regarding long term financing, the City Plan projects $5.1 billion of financing, as set forth in Table 8.

The crux of New York's long term borrowing plan is a $2.025 billion program of Federal loan guarantee for City bonds sold to the City and State pension funds. The City anticipates that the guarantee protection would last for at least ten years, although the City bonds would carry 20 or 25 year maturities. Its proposed guarantee automatically would lapse, however, if the pension funds resold the bonds.

The city's seasonal financing plan

The City projects seasonal borrowings of $1.8 billion next year, declining to $1.0 billion in 1982. This reduction would be accomplished by selling MAC bonds to fund the $800 million advance that the State extends annually to the City.

New York proposes an extended Federal seasonal loan program pursuant to which it would borrow $1.2 billion next year, $800 million in 1980, and $400 mil-

lion in 1981. The remainder of its seasonal needs would be furnished by a $600 million line of credit from the New York Clearinghouse Banks.

Summary of city financing plan

City officials believe that these financing arrangements will permit New York both to meet its full borrowing needs over the 1979–1982 period and to regain full access to conventional markets at the end of that period. Indeed, it projects selling $1 billion of City bonds to the public in 1983, as compared to only $250 million during the final year of the plan period.

VI. THE ADMINISTRATION'S FINANCING PROPOSAL

Background

Our evaluation of the City's financing plan is that it is well-conceived and would achieve its objective. We have however, two reservations: First, our analysis of the Plan leads us to conclude that the City can adequately provide for its capital requirements by selling somewhat less—perhaps $4½ billion—than the $5.1 billion in long-term securities during the year 1979–1982, which the Plan projects. Second, we believe that this reduced level of long-term financing can be assured with more modest Federal assistance.

I want to emphasize, however, that we have concluded that the City's solvency would not be assured in the absence of any Federal lending assistance beyond June 30, 1978. In this regard, therefore, we disagree with the conclusions of the recently issued Senate Banking Committee Report on New York City. While it is conceivable that if every contingency is favorably resolved, no additional federal lending assistance to the City will be required, we do not believe it would be responsible to risk bankruptcy should events prove this judgment wrong. New York City in bankruptcy will prove far more expensive to this nation—both in expense and personal sacrifice—than any modest form of assistance.

Let me now outline the reasons why I believe there must be some federal long-term lending assistance. Any long-term financing plan for New York must rely on the sale to the public of large amounts of MAC bonds and City bonds. The City's own plan projects $1.85 billion of such public sales and the Senate Report forecasts only modestly lower amounts.

The receptivity of public markets to those sales, however, is far from assured. Today there is no market for City bonds at all. Moreover, the market for MAC offerings in recent months has been quite limited, and last December's $250 million MAC offering was barely completed. It is entirely possible, therefore, that the public markets will not supply the amounts of long-term capital which New York needs to meet its minimal capital needs. Unless there is a federal backstop, to assure that these amounts can be obtained, the City's solvency simply cannot be assured.

It is logical to ask whether local private parties primarily the City pension funds and the local financial institutions, can supply these long-term needs of the City. Our conclusion is that they can and should supply a large portion of those needs, but we cannot be certain that they will be able to supply all of such needs.

It also is logical to ask whether insolvency necessarily would result from the unavailability of those public markets. The Administration's view is that insolvency could well result.

It also has been proposed that Congress simply extend the seasonal loan program, on a reduced and self-liquidating basis. We do not think that this is the best approach. It does not assure that New York's long-term needs are met and that the financing crisis thus will finally end.

Specific proposal

We propose that Congress (i) authorize the Secretary of the Treasury in the four years ending June 30, 1982, to guarantee for up to 15 years up to $2 billion in aggregate principal amount of taxable NYC or MAC securities, with a minimum annual guarantee fee of ½% per annum payable on any outstanding guaranteed securities; and (ii) amend PL 94–236 to permit the City and State

employee pension funds to purchase City or MAC securities during the 1979–1982 period.

Guarantees authorized by the Congress would be issued only under the following conditions, among others:

For fiscal year 1979, the City will adopt a four-year budget plan that by 1982 produces a budget balanced in accordance with Generally Accepted Accounting Principles (GAAP), and will continue to adopt and adhere to rolling four-year budget plans that for 1982 and thereafter are balanced in accordance with GAAP. The City periodically will submit to the Secretary financial statements as required.

New York State will enact legislation to ensure the existence of a fiscal control and monitoring entity with powers no less extensive than the current Emergency Financial Control Board (EFCB). This entity would be in existence for at least the life of the Federal guarantees.

New York State will enact appropriate legislation to facilitate the public sale of MAC and New York City long-term securities, in particular, to provide appropriate security and legal authority for such securities.

Federal guarantees will be appropriately secured first by federal transfer payments to New York City and secondarily by New York State in a form such as a State-funded debt reserve account and/or the pledge of an appropriate amount of certain federal transfer payments to New York State.

A long-term financing plan for New York cannot work without the cooperation of the relevant local parties—the City and State pension funds, the Clearinghouse banks and other local financial institutions, and others. The exact division of lending commitments among these parties is a matter for detailed negotiation over the near term future in light of the prevailing conditions. It is clear, however, that each of these key parties must make a major lending contribution.

In general, I think that up to $2 billion of MAC and City bonds can and should be sold to the public during the next four years on an unguaranteed basis and additional amounts to private lenders. Federal guarantees will be issued only to the extent that the public markets and private lenders do not provide the necessary funds on an unguaranteed basis. However, it would not be my intention to issue Federal guarantees unless other lenders to New York City make long-term lending commitments on an unguaranteed basis. The timing of the issuance of Federal guarantees and the size of purchases of non-guaranteed MAC or NYC long-term obligations by lenders will have to be worked out as part of an overall financing solution.

The precise form and coverage of this guarantee would be negotiated before June 30, 1978. Among other things, however, the guarantee would lapse if the guaranteed securities were sold by the original purchasers.

While we are asking for authority to issue guarantees of up to 15 years, I intend and expect that it will not be necessary to issue any guarantees with a length of as long as 15 years. It will be my intention, in the negotiations that will take place with potential lenders, to keep the length of Federal guarantees as short as feasible. Similarly, since we require that a "best efforts test" be met before any guarantees would be issued, we hope to avoid full use of the guarantee power.

Seasonal financing

My judgment is that New York can satisfy its own short-term borrowing needs, provided that Federal guarantee authority as outlined above is available concerning its long-term financing. Before Congress enacts guarantee legislation, however, New York should prepare a seasonal financing plan satisfactory to the Treasury. I have asked Mayor Koch to do so.

If my judgment changes over the near term future on New York's ability to meet its own short-term needs, I will report accordingly to Congress.

Conclusion

We look forward to working with Subcommittee staff on the details of our proposed legislation. I also will be happy to answer now any questions you might have.

TABLE 1.—SUMMARY OF THE NEW YORK CITY BUDGET, FISCAL YEAR 1975 THROUGH FISCAL YEAR 1978 (ESTIMATED)[1]

[In millions of dollars]

	Fiscal year—			
	1975	1976	1977	1978
Revenues:				
General sources:				
Sales tax	791	828	867	901
Personal income tax	466	615	742	756
General corporation tax	268	443	519	504
Water and sewer charges	238	218	206	231
Stock transfer tax	185	270	279	250
Financial corporation tax	114	202	149	168
Other	1,555	1,128	1,205	1,242
Total general sources	3,617	3,704	3,967	4,052
Real estate tax	2,896	2,966	3,236	3,160
Federal and State aid	5,452	5,339	5,435	6,083
Total revenues	11,965	12,009	12,630	13,303
Expenses:				
Social services	3,402	3,746	3,774	3,906
Education	2,345	3,010	2,481	2,564
Health and sanitation	1,187	1,377	1,325	1,346
Police	654	652	669	661
Fire	282	285	292	297
Debt service[2]	1,827	1,847	1,747	1,607
MAC debt service		462	597	402
Pensions[2]	987	1,137	1,209	1,188
Other	1,269	461	873	1,332
Total expenses	12,033	12,977	12,967	13,303
Deficit	68	968	329	
	[2] 1,107			
Operating expenditures in capital budget	724	654	615	640
Estimated adjusted deficit	1,831	1,622	944	640

[1] Does not include operating expenditures included in the capital budget.
[2] The 1975 deficit of $1,107,000,000 was calculated by adjusting certain revenue categories to reflect the revised accounting and reporting procedures that would be used in fiscal year 1976 and thereafter.

Source: Annual Report of the Comptroller, Part 2-A, Statement 5 and Summary 1.

NEW YORK CITY SEASONAL LOAN PROGRAM BORROWING AND REPAYMENT SCHEDULE, CITY FISCAL YEARS 1976-78

Borrowing date	Maturity date	Amount (millions)	Interest rate (percent)	Interest due (millions)
1976:				
Dec. 18, 1975	Apr. 20, 1976 [1]	$130	6.92	2.958
Dec. 31, 1975	May 20, 1976 [2]	240	6.68	6.105
Jan. 15, 1976	Apr. 20, 1976 [1]	140	6.13	2.163
Feb. 11, 1976	June 20, 1976 [2]	250	6.29	5.514
Feb. 17, 1976	June 25, 1976	80	6.26	1.770
Do	June 30, 1976	100	6.26	2.293
Mar. 1, 1976	do.[2]	250	6.39	5.077
Mar. 15, 1976	do.[3]	70	6.33	1.238
Total		1,260	6.43	27.122
1977:				
July 1, 1976	Apr. 20, 1977 [3]	500	7.37	29.076
July 16, 1976	do.[3]	150	7.02	7.876
Do	May 20, 1977 [1]	200	7.10	11.827
Aug. 4, 1976	do.[1]	225	7.04	12.368
Dec. 1, 1976	June 20, 1977 [1]	200	5.85	6.315
Dec. 8, 1976	do.[1]	200	5.83	6.070
Dec. 22, 1976	do.[1]	200	5.73	5.526
Dec. 30, 1976	June 30, 1977 [4]	170	5.75	4.874
Mar. 14, 1977	do.[4]	255	5.92	4.466
Total		2,100	6.53	88.398
1978:				
July 5, 1977	Apr. 20, 1978	300	6.65	15.796
July 18, 1977	do	100	6.80	5.142
Do	May 20, 1978	150	6.85	8.670
July 29, 1977	Apr. 20, 1978	200	6.93	10.063
Aug. 16, 1977	do	50	7.36	2.490
Do	May 5, 1978	100	7.38	5.297
Sept. 19, 1977	May 20, 1978	250	7.46	12.518
Oct. 4, 1977	do	50	7.54	2.376
Do	June 20, 1978	275	7.58	14.791
Dec. 5, 1977	do	150	7.75	6.274
Dec. 28, 1977	do	50	7.73	1.842
Do	June 30, 1978	200	7.75	7.814
Total		1,875	7.26	93.075

[1] Repaid 4 days early.
[2] Repaid 2 days early.
[3] Repaid 5 days early.
[4] Repaid 1 day early.

TABLE 3.—SUMMARY OF REVENUES AND EXPENSES, FISCAL YEARS 1978-82

[In millions of dollars]

	Fiscal year—				
	1978[1]	1979	1980	1981	1982
Revenues:					
General sources:					
Sales tax	901	959	1,012	1,065	1,137
Personal income tax	756	811	859	907	958
General corporation tax	504	526	555	606	671
Water and sewer charges	231	232	232	234	234
Stock transfer tax	250	197	140	121	83
Financial tax	168	151	158	169	205
New York State revenue sharing	533	526	591	615	677
Federal revenue sharing	305	306	303	311	312
Federal counterc cyclical	140	84	57		
Other	1,242	1,066	995	995	1,001
Total general sources	5,030	4,858	4,902	5,023	5,278
Real estate taxes	3,163	3,155	3,117	3,105	3,127
Federal and State categorical aid	5,230	5,232	5,489	5,659	5,870
Subtotal	13,428	13,295	13,508	13,787	14,275
Less: Reserve for disallowances	125	100	100	100	100
Total revenues	13,303	13,195	13,408	13,687	14,175
Expenses:					
Personal service:					
Salaries and wages	3,866	3,877	3,877	3,877	3,877
Fringe benefits	446	526	575	631	691
Pensions	1,188	1,247	1,306	1,375	1,405
Total personal service	5,500	5,650	5,758	5,883	5,973
Other than personal service:					
Supplies, equipment, and contractual services	1,695	1,792	1,904	2,040	2,169
Public assistance	1,454	1,498	1,538	1,576	1,615
Medical assistance	1,413	1,603	1,753	1,868	1,989
Health and Hospital Corp.:					
General support	242	242	242	242	242
Medicaid	480	503	528	554	582
Other	1,029	788	758	740	745
Total other than personal service	6,313	6,426	6,723	7,020	7,342
Debt service	1,627	1,535	1,436	1,341	1,268
Mac debt service	440	466	474	497	555
General reserve	141	100	100	100	100
Accrued pension liability	120	115	100	10	
Expense items properly chargeable to the capital budget	(75)	(75)	(79)	(101)	(109)
Total expenses	14,066	14,217	14,512	14,750	15,129
Budget gap	763	1,022	1,104	1,063	954
Adjustments permitted by emergency financial legislation and MAC Act:					
Accrued pension liability	(120)	(115)	(100)	(10)	
Expense items chargeable to the capital budget	(643)	(450)	(300)	(150)	
Adjusted budget gap		457	704	903	954

[1] Preliminary.

Source: City plan.

SUMMARY OF THE CITY'S PROJECTED BUDGET GAPS AND CORRECTIVE ACTIONS FISCAL YEAR 1978-82

[In millions of dollars]

	Fiscal year—			
	1979	1980	1981	1982
Budget gap	1,022	1,104	1,063	954
Adjustments permitted under State law:				
Accrued pension liability	(115)	(100)	(10)	
Expense items included in capital budget	(450)	(300)	(550)	
Gap to be closed	457	704	903	954
Corrective actions:				
Proposed city actions	174	337	452	554
Remaining gap	283	367	451	410
Proposed State actions	433	487	484	757
Proposed Federal actions	224	379	484	452
Total	657	866	1,068	1,209

Source: City plan Jan. 20, 1978 (to be amended as new data available).

MAJOR ASSUMPTIONS IN CITY 4-YEAR PLAN

Overall assumptions:

1. National economic activity will be maintained at about its current pace.
2. Certain existing State and Federal programs will be continued.
3. No legal settlements, social or political events will alter significantly particular revenue or expenditure items.

Revenue assumptions:

1. General source revenue growth at 1.2 percent per annum on average (includes State and Federal revenue sharing over period and Federal countercyclical through 1980).
2. Real estate tax collections are virtually flat.
3. Federal and State aid growth at 3 percent per annum on average.
4. Complete phaseout of expense items financed in the capital budget by 1981.

Expenditure assumptions:

1. A welfare case load in the 1979-82 period little changed from current level.
2. No increase in subsidies to the health and hospital corporation and the transit authority.
3. No increase in the level of salaries and wages, although fringes and pension contributions will rise.

TABLE 4.—SUMMARY OF THE CITY'S PROPOSED PROGRAM ACTIONS TO ELIMINATE BUDGET GAP—4-YEAR FINANCIAL PLAN, FISCAL YEAR 1979-80

[In millions of dollars]

	Fiscal year —			
	1979	1980	1981	1982
City actions:				
Welfare: Reduction in error rates and improved job placement	14	22	23	23
Health:				
Medicaid utilization control through health maintenance organizations		31	34	36
Home care services improvements	10	11	11	11
Personnel and management:				
Reduction of staff by 10 percent through attrition over 4 years (4 percent in 1979, 3 percent in 1980, 2 percent in 1981, 1 percent in 1982)	65	147	222	280
OTPS cost containment to 3 percent growth	23	45	69	94
Management improvements	62	81	93	100
Total, city actions	174	337	452	544

TABLE 5.—SUMMARY OF THE CITY'S PROPOSED STATE PROGRAM ACTIONS TO ELIMINATE BUDGET GAP—4-YEAR FINANCIAL PLAN, FISCAL YEAR 1979–80

[In millions of dollars]

	Fiscal year—			
	1979	1980	1981	1982
State actions:				
Welfare:				
Local share-excess supplementary security payments	11	11	11	11
Reduction of welfare fraud-wage reporting system	6	19	38	53
Increase in State share of home relief	25	26	26	27
State assumption of local share of AFDC	56	113	173	237
Payment for State mental hygiene discharges	2	2	3	3
Day care reimbursement policy	2	2	2	2
Health:				
Voluntary hospital improvement	1	2	2	2
Mandatory 2d opinion for elective surgery	9	9	10	11
Payment of fringe benefits cost for State supported employees	8	8	8	8
Revenue sharing and other unrestricted aid:				
Insurance corporation indemnification	15	15	15	15
Municipal overburden	58	58	58	53
Railroad tax exemption	16	16	16	15
Revenue sharing formula	88	98	102	153
City university: Increase of State subsidy for CUNY, including CUCF payments	35	47	59	72
Criminal justice:				
Temporary housing of State prisoners	6	6	6	6
Full payment of State share of probation formula cost	1	1	1	1
Highways: Highway maintenance reimbursement	25	25	25	25
Housing: Reimbursement for police protection in public housing	11	11	11	11
Mental health: Reduction of local share	18	18	18	18
1 time revenues:				
Mental health disallowances	20			
6 party check disallowances	20			
Total, State actions	433	487	584	757

TABLE 6.—SUMMARY OF THE CITY'S PROPOSED FEDERAL PROGRAM ACTIONS TO ELIMINATE BUDGET GAP—4-YEAR FINANCIAL PLAN, FY 1979

[In millions of dollars]

	Fiscal year—			
	1979	1980	1981	1982
eral actions:				
Welfare:				
Moynihan welfare relief	28	25	6	
Welfare reform			54	16
Acceleration of the transfer of children to SSI	5	5	5	5
Expansion of the SSI definition of disability	5	5	5	5
Revised income eligibility standards for foster care	3	3	4	4
Health:				
Medicare funding of skilled nursing facilities (SNF)		117	125	132
Impartial inpatient hospital reviews		12	13	14
Revenue sharing and other unrestricted aid:				
United Nations tax contribution	8	8	8	8
United Nations diplomatic security costs	3	3	3	3
Elimination of the 145 percent ceiling on revenue sharing	6	8	8	9
Revenue sharing—Population estimates	20	20	20	20
Revenue sharing—Stock transfer tax	7	7	6	4
Extension of countercyclical aid with a hold harmless provision	56	83	140	140
Criminal justice:				
Improved living conditions in correctional facilities as mandated by Federal courts	5	5	5	5
Drug law enforcement	34	34	34	34
Housing:				
Increased reimbursement for police protection in public housing	17	17	17	17
Federal conversion of city/State aided public housing	66	26	30	35
Parks and recreation: Gateway National Park	1	1	1	
Total, Federal actions	224	379	424	452

TABLE 7.—FEDERAL AID TO NEW YORK CITY—CITY FISCAL YEARS 1973–78

[In millions of dollars]

Type of aid	1973	1974	1975	1976	1977	1978
Categorical aid	1,790	1,783	2,217	2,262	2,421	2,808
Revenue sharing (including ARFA)	259	267	257	263	290	479
Total	2,049	2,050	2,474	2,525	2,711	3,287

Source: Temporary commission on city finance and city comptroller reports.

TABLE 8.—*City financing plan*

Item	*Amount*
Uses of funds:	
True capital spending	$2.590
Funding of operating expenses	.900
MAC restructuring	.560
MAC capital reserve	.250
Bonding of State advance	.800
Total	5.100
Sources of borrowings:	
City and State pension funds (USG guaranteed)	[1] 2.25
MAC private placement: local financial institutions	1.000
MAC sales to public	1.510
City bonds to public	.340
Total	5.100

[1] 90 percent USG guaranteed—$2.025.

Secretary BLUMENTHAL. It has operated in compliance with the requirements of the Emergency Financial Control Board. It has reduced the number of jobs substantially—there are 60,000 jobs which have been eliminated in New York.

It really has done a great deal, with the help of everybody in the city, to get back to a normal basis.

Two things are required, one that true balance be established in the budget. Such a plan has been drawn up. We have examined it in great detail. I have spent months on this problem. I am satisfied that that plan, if adhered to, will indeed lead to true budget balance in the fourth year with all of the operating expenses eliminated from the capital budget.

Second, as a result of that, the public market should be again opened up to the city. As you well know, once you have been shut out as a borrower from the market, it takes awhile to get back in. At this point, there is just no way in which the city on its own can go into the markets and borow money. They tried last November; they failed.

We think that you have to let some time elapse, based on this budget plan, before they can try again and I think they will then progressively be more and more successful so that by the end of the fourth year they would be entirely on their own again.

In view of that improving situation, we think that seasonal lending is no longer required. We do not have to put out any more Federal money as we have been over the last 3 years, even though, again, the city has been very good about making sure that all of the moneys that they did receive in the way of advances were repaid to us on or ahead of schedule with full interest payments so that the obligations there were met. We think that is no longer necessary. They can do their own seasonal financing.

But, in order to give the city sufficient time to gain full access to the public markets again, we are recommending that the Federal Government be authorized, specifically Treasury be authorized by the Congress, to guarantee up to $2 billion of bonds out of a $4.5 billion amount that will be needed over the 4-year period, if they cannot get such loans without the guarantee, and that those guarantees, in fact, would most likely be extended to the pension funds.

Now, it is my view that a package has to be negotiated in which there certainly can be a fair amount of lending without any guarantees, but that is something for the negotiations. These guarantees are available on a standby basis, if needed.

So really, the situation, even for the funds, is going to be improved over the situation that has existed and that Congress authorized between 1975 and June 30, 1978.

The plan that we are presenting and that we are urging you to consider seriously is, I think, a realistic one. It does require that legislation along the lines of the legislation that you enacted in 1975, Public Law 94–236, be enacted. As I say, failure to do that would automatically, in my judgment, put the city into serious risk of bankruptcy and the result of that on the funds would be difficult to foresee but would be very serious indeed.

So I do hope that you will give this serious consideration, to allow this workout to be completed over the next 4 years so that the city can again operate under its own steam.

Senator BENTSEN. Mr. Secretary, that is certainly no limitation on your time to speak on this very serious subject, because we are deeply concerned with it, and we know you are.

Secretary BLUMENTHAL. I am finished.

Senator BENTSEN. But I am concerned about its being a precedent. I do not know how we can argue that if we can do this for New York City that we do not have to do it for the next city that gets in trouble.

I am also concerned about the fact that you have $3.5 billion of the $10 billion of those pension assets which will be invested in these kinds of securities by June 30 of this year and, as I understand your proposal, you are talking about an additional commitment of some $2.25 billion.

If that is the case, you run up to about $5.7 billion—or are you talking about some refinancing of part of the initial?

Secretary BLUMENTHAL. We are requesting legislation which would not mandate the funds to do anything. It would permit them, or it would protect them, against the loss of qualified status if they were to maintain the same percenage that they have invested in city and MAC securities as of June 30 of this year, which will be about 35 percent.

So they would maintain that percentage as a maximum level of investment.

Now, whether they would actually would have to, I do not know. But we are not telling them that they have to invest a particular amount. We are merely saying that they——

Senator BENTSEN. Well, would we give them the leeway to do it, with your proposal?

Secretary BLUMENTHAL. Up to 35 percent, so roughly that same percentage that exists currently.

Senator BENTSEN. So it would not be $2.25 billion in addition to the $3.5 billion that they have already there?

Secretary BLUMENTHAL. Well, at the end of the fourth year. To maintain the 35 percent level of investment we estimate that the pension funds would hold around $4.8 billion at June 30, 1982. This would imply the reinvestment of about $1 billion of maturing principle and new investment of about $1.3 billion.

Senator BENTSEN. So out of the $10 billion, they could have much as 45 percent?

Secretary BLUMENTHAL. No; by that time, their total assets would have increased as well. The percentage would not rise above 35 percent.

Senator BENTSEN. It would not rise above 35 percent.

Now, in ERISA we put a limitation of 10-percent investment in one's own securities, which seemed to us to be prudent. Many banks say they will not put more than 5 percent in the investment of the securities of any single corporation.

I find it difficult to understand why we should reach far beyond what we think would be a prudent investment to try to protect these retired pension holders.

Secretary BLUMENTHAL. If you ask me is it prudent to invest 35 percent of the assets of a fund in your employers' paper I would say under all but the most extraordinary circumstances, it is not. I think your restriction of 10 percent in ERISA is a wise one. Perhaps even less would be prudent.

Certainly, when I was acting as a fiduciary for funds, I would have been very cautious about even 10 percent. I think the New York City situation is an extraordinary situation, which is unlike any other, and which has to be evaluated based on present circumstances.

The present circumstances are such that the city, the employer, is shut out from the credit market. It depends on these resources for financing to a significant extent. It is in the process of working itself out of these problems. This employer, the city of New York, is making good progress. But if, in the middle of it, you pull out the rug from under the workout plan, you might as well never have started it.

You will precipitate, then, exactly the kind of situation that you are quite rightly concerned about, which is to protect not only the retirees but also those actively working who have vested rights and those who are working and do not yet have vested rights. And you would throw the city into default with all of those consequences.

Therefore, I think a program which allows the city to complete its workout plan, achieve true budget balance, get back into the market and allow the city pension funds to reduce their percentage of city and MAC debt holdings thereafter is the only sensible thing.

It is certainly not a desirable general situation, but then these workout situations never are.

Senator BENTSEN. Mr. Secretary, what do you think the market value is of the bonds that they hold now? And I am speaking of MAC bonds and New York City bonds.

They hold some $3.5 billion of them. What is the market value of the bonds?

Secretary BLUMENTHAL. I cannot—I do not really know how to answer that. I have no——

Senator BENTSEN. Do they have any market?

Secretary BLUMENTHAL. Certainly the MAC bonds have a value. I think the city bonds, by definition, do not at the moment.

Senator BENTSEN. Would you provide for the record the best information that you can get as to the market value of the securities held by the pension funds that involves New York City and MAC?

[The following was subsequently supplied for the record:]

MARKET VALUE OF CITY PENSION FUNDS HOLDINGS OF MAC AND CITY DEBT

It is anticipated that the city pension funds will hold $3.5 billion of city and MAC debt at June 30, 1978. Of this amount, $886 million will be in MAC debt and the balance in city general obligation bonds.

The bulk of their MAC debt holdings are in 7½ percent bonds due in 1995. These bonds are currently trading at around 95 percent of par value. The pension funds hold city securities with maturities spread over a considerable time period. In general, trades in city securities with comparable maturities and coupons are reported to have taken place recently at 95 percent to 102 percent of par value. It should be noted that the market for both city and MAC securities experiences significant fluctuations depending largely on the amounts of bonds offered for sale.

It is also relevant to point out that the history of municipal debt repayments suggests that investors in municipal securities rarely experience any acual loss in principal even when an event of default has occurred. Testimony given by the bank regulatory agencies in 1975 suggested that the market value of city bonds in the event of default would probably be around 50 percent of par value.

Senator BENTSEN. Now, Mr. Secretary, I am concerned about the conflict of interest position of the trustees. Let me read you a comment out of one of the New York papers:

> In meeting after meeting with New York City officials, labor union's consultant and key negotiator has a favorite negotiating position. Everything is related to everything else, he says, a statement that city officials take to mean that if the pension funds are pressed to accept larger parts of unguaranteed bonds, they could reasonably demand a more generous wage settlement in return.

Does that mean that a trustee is in there bargaining on the one hand for current employees to get their wage rates as high as he possibly can while, at the same time, has an obligation to the retiree to see that that city is fiscally sound?

Do you not think, under those conditions, that some of those retirees ought to be added to the board of trustees?

Secretary BLUMENTHAL. I think, Mr. Chairman, that in the heat of the negotiating season, people say things that may or may not make as much sense as they should.

It seems to me clear that there are two quite different and separate positions here. One is the decision of what the wage settlement will be between the employees and the city of New York. I do not think the Federal Government should inject itself, or that I should inject myself, into those negotiations. I have made it clear in my testimony before the Moorhead committee that true budget balance is critical. Nothing else will work.

They cannot work themselves out of their problem if they do not have the budget balanced based on generally accepted accounting principles.

The plan that we have seen and upon which we are basing our recommendation to the Congress for the right to guarantee under certain circumstances has no money in it for wage increases, and therefore

any wage increases that are approved by the city have to be financed by productivity or related savings.

Beyond that, I do not think we ought to get involved. It seems to me that that is one set of issues.

The question of whether or not the city pension funds will or will not invest on either a guaranteed or an unguaranteed basis in city or MAC paper strikes me as an issue that is totally separate. Some people can say they are related, but I think that is just talk, quite frankly. I think these issues are obviously separate.

It relates to a question of whether or not it is judged by the trustees to be in the best interest of not only the retirees but also those employees with vested rights that are still working as well as those who are contributing.

And the best interests, obviously, have to involve a consideration, not only as to the existing viability of the fund, which have accrued unfunded liabilities in large amounts attached to them, but also as to the continued viability and access to resources to pay those pension benefits, present and future, in the light of either a situation where you withdraw support or you maintain it for a further period of time.

I cannot imagine that the trustees would act analyzing this problem in any other way.

Senator BENTSEN. Mr. Secretary, you cannot? But, nevertheless, you have labor officials and city officials who look upon them as interrelated and who feel that there is a quid pro quo there, that they have to give some on wage scale in order to get these same trustees to buy more New York City securities. To me, that is clear conflict of interest.

Secretary BLUMENTHAL. Mr. Chairman, may I make just one point? I think it is an important one. I think the President's position as I presented it to the Moorhead committee is quite relevant to that. Our proposal to the Congress for authority to be given to the Secretary of the Treasury to guarantee up to $2 billion, of standby guarantees of $2 billion of bonds, is based on the assumption that there will be true budget balance and that the budget plan will be healthy.

Senator BENTSEN. I am delighted to hear you say that, because——

Secretary BLUMENTHAL. So there is no money——

Senator BENTSEN [continuing]. Because it obviously is not in balance by any commonly accepted accounting practices.

Secretary BLUMENTHAL. Therefore—you cannot buy one with the other, let's put it that way. It does not seem very easy to do that unless there is productivity or related savings. And, of course, we all want to see the efficiency of the operations improved there.

Unless there is productivity or related savings, I do not see how the city could find any money to pay wage increases anyway.

So I think there is—when you look at the reality of the situation—and if they did, and they would deviate from the budget plan, then the assumption upon which our proposal is based would not be met.

Senator BENTSEN. Well, when the 1975 agreement was changed to the 1977 agreement, it was my understanding that the requirement for a balanced budget was deleted. Does that not take some of the discipline off?

Secretary BLUMENTHAL. I noted an article in the newspaper, which I believe you were quoting, as commenting on that. I have looked into that, Mr. Chairman, and I believe the situation is as follows. At the

time the agreement was amended in 1977, it was judged that the balanced budget provision was superfluous for several reasons.

First, the city had already adopted a balanced budget—and I always put that in quotation marks, because it is balanced by State law—had adopted a balanced budget for 1978, that it had been approved by the EFCB. The New York State law establishing the EFCB required the city to follow the 3-year plan in accordance with State law and that that was being met. And third, the Treasury's credit agreement for seasonal loans also required the city to adhere to the plan.

In view of these three other provisions, each requiring the same thing, it was judged by the lawyers that this particular provision need not be repeated because it was already required in three other areas. Whether or not it should be required a fourth time or not, I do not really——

Senator BENTSEN. Mr. Secretary, I really do not buy that argument. When something is of major importance like that and such a subject of debate in Congress, the fact that it might be considered superfluous—and frankly, I do not think it was—and when you say yourself—and I agree with you—that they were not in balance, according to commonly accepted accounting practices, I feel that there was a reason for that. And the reason was not that it was superfluous, but it was looked on as inhibiting and a further discipline.

Now, I have taken a great deal of the Secretary's time and I yield to the Senator from Virginia, Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Secretary, in regard to the issue of a balanced budget for New York City, the—New York committed itself 3 years ago to a balanced budget. It was committed to balance the budget in 1978. None of that has been complied with.

Your proposal, as I understand it, is to give an additional 4 years over and beyond the first 3 years for New York to balance its budget. Does that seem reasonable?

Secretary BLUMENTHAL. Senator, we are well on the way to misunderstanding here. The city of New York committed itself to balance the budget based on existing State law. It has achieved that. It has met its commitment. Indeed, it will have a surplus this year.

However, State law, defining budget balance, still permits the placing of certain operating expenditures into the capital budget, so I do not call that true balance. The State of New York does, but I do not call it true balance.

Under the plan that has now been worked out by the city and the State that we have examined and that I consider to be a reasonable plan, all of those operating expenses that are still in the capital budget will be phased out and they will achieve a balanced budget, not only by State law, but based on generally accepted accounting principles.

Senator BYRD. State law was based on the fact that the State, as well as the city, desires to obtain something from the Federal Government.

Senator Bentsen pointed out—and you have concurred in it—that by any generally accepted principle of accounting, New York City's budget has not been balanced during any of these past 3 years, leaving out the previous time. And, under your proposal, it would not be balanced for another 4 years.

That is correct, is it not?

Secretary BLUMENTHAL. Based on generally accepted accounting principles, the budget has not been balanced. But, based on the law that was passed by the Congress, it has been balanced. That is the point, I think, where we must be sure that there is no misunderstanding.

What the city was committed to do was not to balance the budget by 1978 based on generally accepted accounting principles but to balance it each year under State law. It did that; indeed, it had a surplus.

Now, we have said, look, you cannot get access to the markets unless you do that based on generally accepted accounting principles, and that is what they now have presented—a plan to do over the next 4 years.

Senator BENTSEN. If the Senator would yield for just a moment——

Senator BYRD. Yes.

Senator BENTSEN [continuing]. What I would really like New York City to do is just keep one set of books, not just a set for the Congress and another one for the State of New York. And I would hope that the Secretary would submit for the record so we do not develop this misunderstanding in the future something for the record on commonly accepted accounting practices, a more full definition.

[The following was subsequently supplied for the record:]

ACCOUNTING PROCEDURES AND NEW YORK CITY'S BUDGET

If New York City adheres to its four-year plan, then at the end of 1982 the city will report that its budget was balanced according to generally accepted accounting principles (GAAP) as applied to governmental units. The city will likely report a budget for 1978 balanced in accordance with New York State law, but not with GAAP.

New York City is permitted under State law (the law creating the Municipal Assistance Corporation) to include a declining amount of operating expenses in the city's capital budget and to contribute to the city pension funds with a two year lag. GAAP would call for operating expenses to be carried in the current expense budget and that pension fund contributions be accrued in the year in which the liability is incurred.

To conform with GAAP, city operating expenses carried in its capital budget will be phased out by the end of its 1981 fiscal year. In addition, the city plans to implement the "Shinn Commission" recommendations for the city pension funds with regard to actuarial methods and funding procedures. Implementation of these recommendations will eliminate any variance with GAAP with respect to pension contributions by the last year of the plan.

Senator BYRD. I think the Congress, in expecting the city to balance its budget, expected it to balance it on the basis of commonly accepted accounting practices. The city, as I understand it, was in violation of the New York State law, and the New York State law was then changed to where they were no longer in violation of it. Is that about the situation?

Secretary BLUMENTHAL. I do not—in 1975, I do not believe that that is quite correct. I think at the time the law was passed in 1975 and at the time Public Law 94–236 was enacted, the requirement of budget balance, I believe, was clearly defined.

You see, the amount in the operating expenses in the capital budget at that time was about $800 million. It was clearly realized that that could not be eliminated, you could not achieve true balance by eliminating all of that in a short period of time. I believe it was foreseen that that would be phased out over 10 years.

What we have now said is that they need to phase that out much faster and take the balance, which is still some $650 million, I believe, and phase it out by the end of the third year of the plan.

Senator BYRD. Well, I do not think that that was the thinking of the Congress and I think that is evidenced by Senator Proxmire's attitude, and Senator Proxmire is the man who handled the legislation in 1975.

Now, is there an audit opinion on the state of the city's finances?

Secretary BLUMENTHAL. Yes; there will be for the current fiscal year.

Senator BYRD. Is the city now auditable?

Secretary BLUMENTHAL. Yes; it is.

Senator BYRD. How do you consider the quality of the city's recordkeeping?

Secretary BLUMENTHAL. I think compared to—I have talked to the people at Arthur Anderson who have been doing a great deal of this work; compared to what it was in 1975 it is vastly improved.

They do have a vastly better budgeting and cost control procedure than they have had. They have installed all kinds of EDP equipment, or devices to handle that, and the situation is vastly improved.

Senator BYRD. Under your plan, would there not be two types of bonds, one being guaranteed by the Federal Government and another one not being guaranteed? What problems would that cause?

Secretary BLUMENTHAL. The guarantees under that plan would only be extended to the extent needed, and most likely only for the pension funds, not for the public.

Senator BYRD. But would not having two types of bonds, one guaranteed and the other not guaranteed, present problems?

Secretary BLUMENTHAL. I do not think that it would represent insurmountable problems.

Senator BYRD. Now, the administration has indicated that the current loan guarantees of the Federal Government have gotten so large that they are not able to be effectively included in the budget process of the Federal Government.

If this is so, how does this policy match with the current administration proposal to extend the guarantees to New York City?

Secretary BLUMENTHAL. As I understand it, the amount of similar guarantees that have been extended, or analogous guarantees, is about $270 billion, Senator. Actually, the $2 billion of possible guarantees is quite small in comparison to the amount that the Federal Government is presently guaranteeing in the way of funds.

Senator BYRD. I am speaking now of the total Federal loan guarantee program, and I understand—maybe I am in error—but I understand that the administration would like to cut back on the loan guarantee programs of the Federal Government. Is that not correct?

Secretary BLUMENTHAL. Oh, certainly. We do not—Senator, I come before the Congress to ask for authority to provide Federal loan guarantees with a very heavy heart. I want to reduce that as much as possible.

I do not think it is a good policy to do that. I do not think the Federal Government ought to do that except in situations where there really is no other way of dealing with what is an urgent problem. I consider the stability of New York City's financial affairs, and getting

them back to stability, to really be an extraordinarily important matter, but I would like to get out of that, and I would hope that we could within a very few years.

Senator BYRD. I have just one further question. The bonds which the Federal Government would guarantee under your proposal would carry what maturity dates? Twenty or twenty-five years?

Secretary BLUMENTHAL. That has not yet been determined. That is going to have to be negotiated now and put together by the responsible people. It is quite possible that they could be 20- or 30-year bonds, or they might be 15-year bonds. I really do not know.

Senator BYRD. Well, then, would the Federal Government guarantee for the life of the bond?

Secretary BLUMENTHAL. Not necessarily.

Senator BYRD. Well, I understand that Comptroller Levitt will not invest the pension funds in New York City obligations unless they are guaranteed for the life of the obligation.

Secretary BLUMENTHAL. I understand that he has so stated.

Senator BYRD. You do not see any problem there insofar as your program is concerned?

Secretary BLUMENTHAL. I think there needs to be an effort by the responsible officials to put together a financing package, given the fact that there is available in the background the possibility of Federal guarantees. In putting that total financing package for a total $4.5 billion together, the terms and conditions of Federal guarantees, if any, where needed, will have to be negotiated as a part of that package negotiation and, in that context, the position of both the city and the State pension fund trustees will have to be an issue and taken into account. That is part of the negotiation.

Senator BYRD. Would the package be put together before or after the legislation is passed, if it is passed?

Secretary BLUMENTHAL. I would hope that it can be—we have a very difficult timing problem there, Senator, because the present seasonal financing act expires on June 30 of this year. At the same time, to get legislation through the Congress takes some time.

At the same time, there is a labor negotiation going on in New York with the first deadline, I think, March 31—well, the end of this month. So we are going to have to do things in parallel.

I would expect the city and MAC officials working with the State to try to put together their financing package in the course of the next couple of months, even before the Congress has acted, so that I am in the position, when I appear before the Senate Finance Committee—before the Senate Banking Committee, for example, to report whether or not the kind of proposals I have made are, indeed, negotiable.

It is my expectation and understanding that they are, and will be. But we are going to have to move in tandem on this so that at the time Congress acts, we have assurance that the authority which Congress would give me will, indeed, result in a financing package that is reasonable and that, incidentally, contains only those guarantees that are absolutely essential—and for as short a period of time as is absolutely essential—to insure the viability of the city of New York so that over the next 4 years they can achieve true budget balance and regain full access of the markets, once again, on their own.

Senator BYRD. What interest rates do you envision for the Government guaranteed bonds?

Secretary BLUMENTHAL. Well, I guess that is another matter that we are going to have to negotiate. I think that may be of interest to some of the fiduciaries and trustees as part of the——

Senator BYRD. And also, you foresee a difference in interest rates between the Government guaranteed bonds and the ones which are not guaranteed by the Government?

Secretary BLUMENTHAL. Yes; because the guarantees would not be for tax exempt bonds. We would propose that whatever guaranteed bonds would have to be issued would be taxable bonds so there would be a difference in interest.

Senator BYRD. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Senator BENTSEN. Mr. Secretary, for the record, I am advised that Public Law 94-236 refers to the 1975 pension agreement and refers to the balanced budget but that the agreement did not mention a "balanced budget under State law."

Mr. Secretary, I am also very much concerned as to the question of a precedent being established here. In fact, I think that is one of my primary concerns. I do not know how you turn down the next city that has this problem.

I agree very much with you that this is an exceedingly serious one, without any easy answers, but it goes far beyond New York City, I think, if we start guaranteeing these.

Political pressures will be, I think, almost insurmountable for the next city that gets in trouble.

Secretary BLUMENTHAL. Mr. Chairman, may I just make one brief comment on this? The situation that exists for the city of New York is one that I think every other city in the country will seek to avoid just as much as possible and in that sense, I think, the experience of the city of New York has been a pretty good example.

The establishment of an Emergency Financial Control Board with rather stringent powers—and indeed, we are, in our proposal, indicating that a further prerequisite of the authority that we are seeking for the Secretary of the Treasury is the continuation of the control board with powers at least as great as those which have obtained up to this point—is, I do not believe, anything that any city really wishes to face.

It severely restricts the freedom of the city and the city's elected officials to act on their own.

No other city, I think, wants to get itself in the condition where it is excluded from the credit market. And I think, therefore, that given the very special nature of that situation, the only major city that has been shut out, that is operating under an Emergency Control Board, I think we can legitimately say that it is a one-of-a-kind situation and should remain so.

Senator BENTSEN. I hope you are right. Mr. Secretary, we very much appreciate your testimony with all of the demands on your time. We know how concerned you are about this issue and we share that concern.

Thank you for your appearance.

Secretary BLUMENTHAL. Thank you.

[The prepared statement of Secretary Blumenthal follows:]

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL, SECRETARY OF THE TREASURY

Mr. Chairman, I am pleased to be able to appear before you and the other members of this subcommittee to review our experience under P.L. 94-236, which facilitates participation of the New York City pension funds in the city's financing arrangements. I also want to discuss with you our proposal for future pension fund participation in city financing. The administration has been engaged in intensive efforts to assure the continued solvency of New York City, and last Thursday I presented to the Subcommittee on Economic Stabilization of the House Committee on Banking, Housing and Urban Affairs our proposal for continued Federal financing assistance to the city. I have furnished to you and the other members of this subcommittee copies of my prepared testimony before the House subcommittee.

The financing we propose envisions a substantial role for the city and State pension funds. The legislation that I will outline today is designed to allow the pension plans to play that role if their trustees think it prudent and appropriate that they do so.

At the outset, I think it would be useful to briefly review the existing statutory and contractual arrangements relating to city pension fund purchases of city and municipal assistance corporation securities. In November 1975, at the height of the city's financial crisis, the five city pension funds, along with four city sinking funds and several major New York banks, executed and amended and restated agreement. The purpose of that agreement was threefold: one, to require those parties not to tender their city "moratorium" notes; two, to restructure the maturities of and reduce the interest rate on their MAC securities; and three, to commit the pension funds, over the next two and one-half years, to invest $2.5 billion of new money and reinvest any maturing principal of city securities. Since the city had been, and expected to continue to be for some time, unable to sell securities publicly, those commitments were necessary to enable the city to fund its capital budget.

One of the conditions to the purchases by the pension funds was that they receive satisfactory assurances that their participation in that financing arrangement would not jeopardize their qualified status under the Internal Revenue Code. A substantial purchase of city or MAC securities might be deemed a prohibited transaction under § 503 of the code or an action not for the exclusive benefit of the fund beneficiaries for purposes of § 401(a) of the code. Either conclusion would result in loss of qualified status. Qualified status is however, indispensable to these funds. Absent qualified status, each employee-beneficiary would be taxed currently, to the extent his interest was vested, or on the value of city contributions on his behalf to the fund rather than being able to defer taxation until retirement. Also, the fund itself might become liable for tax.

In order to protect against adverse consequences, the funds sought, and the Congress enacted, the legislation that became P.L. 94-236.

P.L. 94-236 is structured around the amended and restated agreement. The law provides that no pension fund that is a party to that agreement will be considered to have engaged in a prohibited transaction or to fail to satisfy the "qualified-plan" requirements merely because it makes the purchases called for or takes any other action contemplated by the agreement. The law also permits the pension plans, when investing in and retaining city or MAC securities, to consider the extent to which that action will in effect maintain and protect the city's obligation to fund retirement benefits.

Amendments and waivers to the agreement are permitted, but only if the Secretary of the Treasury determines that the effect of the amendment or waiver is not inconsistent with the criterion I have just mentioned. Last August, the agreement was amended to provide for exchange of remaining city "moratorium" notes for MAC bonds bearing a higher interest rate, and a restructuring of the maturities of and an increase in the rate on MAC bonds already held, and I determined that the requirement had been met.

Copies of the memoranda setting forth Treasury's analysis were furnished to Chairmen Long and Ullman.

The City pension funds remain committed to purchase an aggregate of $683 million principal amount of City securities during the remainder of the City's current fiscal year, ending June 30, 1978. Table 1 shows, for each City fund, its anticipated total assets on June 30, 1978 and the amount of City and MAC securities it will hold upon completion of all required purchases. On an aggregate basis, the funds will have approximately 35 percent of their assets invested in City and MAC securities.

We should all recognize, Mr. Chairman, the commitment to the City's financial condition and future that is represented by these investments. The trustees of the funds wisely and prudently recognized that the availability of adequate financing to the City was in the continued best interests of their beneficiaries—for otherwise the City's ability to fund retirement benefits would be severely limited, if not lost altogether. This posture was made clear by pension fund representatives during the hearings on P.L. 94–236, and I think that the trustees and other union leaders should be applauded for the responsible role they have played.

That brings me to the present situation. As I mentioned earlier, I have already announced the Administration's proposal for future New York City financing. I do not believe it is necessary to describe it again in detail here. There is one fact, however, that is clear from our proposal. That fact is that the New York employee pension funds must be major participants in any City financing program. Although we expect other local parties, including the clearinghouse banks, other local financial institutions and MAC, to be involved, it is unrealistic to think that before the City can return to the public markets all its borrowing needs can be met without pension fund involvement. Therefore, the Administration proposes that legislation, similar in effect to P.L. 94–236, be enacted to enable the City and State pension funds to make purchases of City and MAC securities during the four-year period beginning July 1, 1978 without jeopardizing their qualified status under the Internal Revenue Code.

Since, at this time, the exact amount of pension fund lending remains to be negotiated, the legislation should be flexible enough to accommodate any level of investment up to specified ceilings. Such ceilings should permit the City pension funds to maintain the percentage levels of investment that will be reached by June 30, 1978. Thus, the funds would be able to reinvest the principal amount of debt that matures during that four-year period, approximately $1 billion. In addition, a portion of the amount of new contributions could be invested.

Up to this time, the State pension funds have not played any meaningful role in the Citys' financing. But, for the reason described below, I feel that they may determine to do so now. Accordingly, appropriate protection of their tax status should be afforded. Our proposal is that the State pension funds should be permitted to invest up to 10 percent of their total assets in City or MAC securities without jeopardizing their qualified status.

I believe, Mr. Chairman, that it is entirely appropriate for us to recommend and for the Congress to enact such legislation. Some may object on the ground that further substantial investments in City or MAC securities are an imprudent investment and risk the future benefits of the covered employees. On the contrary, I believe that such investments are ones that the trustees may well conclude are in the best interests of the covered employees.

One simply cannot escape the conclusion that failure of the pension funds to make substantial purchases could make it impossible for the City to obtain the financing it needs. Without aid from these funds, the City's bankruptcy would seem assured. Bankruptcy would, of course, have a direct and adverse effect on the pension funds. That conclusion is clear for the City funds. Interest and principal payments on the large present holdings of City securities of those funds would likely be halted, and the market value of those securities would drop precipitously. Moreover, the Citys ability to make future contributions would be jeopardized.

A City bankruptcy might also cause adverse consequences for the State pension funds. A City bankruptcy would have financial and economic consequences for the State of New York. Although I am confident that the State's credit will not be materially impaired merely by any uncertainty associated with the ongoing negotiations to secure a resolution of the City's financing problems, a complete failure to secure a resolution could hurt the State. If this failure, however unlikely it now appears to me, were to come about, the ability of the State to make required contributions to its pension funds could be affected.

Under these circumstances, it will be necessary to enact legislation that allows the pension funds to determine what role they should assume in implementing a financing program that allows the City to return to financial health and resume public sale of its securities.

We are not proposing that the pension funds acquire City and MAC securities without any protections or conditions. The Administration's proposed Federal financing assistance is conditioned upon our being able to conclude that the City will adopt and will be able to implement a four-year budget plan that, by 1982,

will produce a budget balanced in accordance with generally accepted accounting principles. Moreover, it is conditioned upon creation of a fiscal control and monitoring entity with powers no less extensive than the current Emergency Financial Control Board. Considerations of that sort will undoubtedly be important factors in any decision by the City and State pension funds to purchase City and MAC securities. We expect shortly to submit a draft of proposed legislation for consideration by your Subcommittee.

I should note that although I have asked Congress for the authority to issue limited federal guarantees of some City or MAC securities, the legislation I am suggesting today should not limit the pension funds to purchasing only such guaranteed securities. The trustees of the pension funds may decide it is appropriate to purchase other types of City or MAC securities.

In conclusion, let me emphasize three points. First, this proposal is not intended to create, and should not be taken as, a precendent for similar legislation for other public or private pension plans that wish statutory exemption from the Code requirements. Rather, it is a part, an essential part, of the Administration's proposal for finally solving New York City's financing problems. Second, the legislation would not require the pension funds to do anything. It is intended only to assure the trustees that, should they determine that investments in City and MAC securities are called for, the qualified status of the funds would not be jeopardized. Finally, it will not increase the risk that Congress will be called upon later to bail out these pension funds. Indeed, Mr. Chairman, only passage of this legislation, and successful efforts to arrange a financing plan for the City, will maximize the likelihood of avoiding the bail out issue.

We look forward to working with your staff on the details of our proposed legislation. I will be happy now to answer any questions you might have.

TABLE 1.—NEW YORK CITY RETIREMENT SYSTEMS ESTIMATED ASSETS AND NEW YORK CITY/MAC DEBT HOLDINGS AT JUNE 30, 1978

[In millions]

	New York City employees	Teachers	Board of education	Police	Fire	Totals
Total assets	5,073	2,600	175	1,644	527	10,019
New York City/MAC debt	1,658	1,198	66	512	107	3,543
Percentage of assets	32.7	46.1	37.7	31.1	20.3	35.4

Senator BENTSEN. We are pleased to have Senator Javits with us this morning and we will now ask him to appear and make his statement.

STATEMENT OF HON. JACOB K. JAVITS, U.S. SENATOR FROM THE STATE OF NEW YORK

Senator JAVITS. Thank you very much, Mr. Chairman. I greatly appreciate the courtesy of the Chair in allowing me to go on, perhaps out of turn.

With the chairman's permission, I would like to make a few brief remarks and insert my prepared statement in the hearing record.

Senator BENTSEN. Your statement shall be included in the record.

Senator JAVITS. Thank you, Mr. Chairman.

My purpose this morning is to give support to an extension of Public Law 94-236 which will allow New York City and State pension fund trustees to acquire New York City securities or other relevant securities like those of the Municipal Assistance Corporation without violation of the fiduciary standards established by the Internal Revenue Code.

There seems to be little question, whatever may be the plan that the Congress agrees upon respecting New York City, if it agrees on any

plan—that it will be very heavily premised on the participation of the State of New York, the employee pension funds of both New York City and New York State, and the banks.

The only real practical question regarding the extension of Public Law 94–236, in my judgment, is the timing. It will be recalled that the Chair was of enormous help to New York City in dealing with this situation of fiduciary responsibility after the Congress had acted on the New York City plan in 1975.

I think it is necessary to make the case as to why the Congress should act now on this particular measure rather than wait until we have acted upon the definitive proposals which were made by the President and perhaps by others.

I think the case for immediate action is very strong, and for the following reason. If we were going the seasonal loan route, one could understand that it would not make much difference whether the action on Public Law 94–236 took place before or after. But if we really want to do something lasting about the New York City situation, we will probably go some other route—the administration recommends the guarantee route for long-term securities with various conditions.

The pieces will have to be fitted together in advance, because the action of the Congress will depend upon what other commitments are in hand. Because the commitment of the pension funds is bound to be a very important piece of the package, it is important that the pension funds be free to negotiate, be free to act, before the final package is put together for congressional approval.

And, in view of the fact that the pension funds of the city, for example, now hold some $2,650 million of these securities representing some 35 percent of their total assets, I think Public Law 94–236's modification of the Code's fiduciary standards must be continued if the trustees are to proceed any further.

And therefore, it is essential that the Finance Committee act on this legislation so as to put them in a negotiating position.

I did not hear Secretary Blumenthal's testimony, but I am sure he made it clear that the U.S. part of it, even if their recommendation is followed, is but a piece of the whole, and that these other parts, including the pension funds, are critically important.

So I appear here today to support the extension of this law and also to urge the committee to take action currently in order to equip this very essential set of parties to participate in the negotiating process.

Senator BENTSEN. Let me say to the distinguished Senator who has done so much work on pension legislation that I was pleased to help on the short-term financing and try to give them time to balance their budget. I did not so participate on the fiduciary relationship, because I have a very deep concern, so far as that.

Are there questions? Senator?

Senator BYRD. No questions.

Senator BENTSEN. Thank you very much.

Senator JAVITS. May I just say one other word, Mr. Chairman? I appreciate the Chair's feeling on the guarantee.

And I believe the burden of proof is on my home city of New York to show that this is the only way to proceed and that it is a matter of

the national interest which must be served in this regard. I have no illusions about this.

I believe that we will have to undertake even more sacrifices, even though, today, the physical assets of New York are in very grave danger of very serious deterioration because of lack of maintenance. It is really cutting into the bone, now.

Nonetheless, with appreciation of the interest and proposals of the President and the Secretary of the Treasury, I believe that it is essential for us to carry the burden of proof, and I believe we can. I really do believe that helping New York is in the national interest and that we can demonstrate that this is a unique situation deserving of unitary attention. And I believe the whole Senate will have to judge what means are the best means for helping the city.

I wish to emphasize to my colleagues, as New York's senior Senator, I will consider that we have the burden of proof to demonstrate that the national interest requires action and requires a particular kind of action.

Senator BENTSEN. Senator Curtis?

Senator CURTIS. I think that the need for a rule or limitation relating to those communities which are not in trouble yet is one thing and the reality of New York City may be another. I do not know.

I think that so far as this committee, and under this particular heading, that our obligation is to the pensioners and the future pensioners rather than the city of New York.

But I would like to know how many pensioners are there in New York and how many would there be, say, 10 years from now, and is there any efficient way of them speaking out in a way that is not too cumbersome?

Senator JAVITS. Senator Curtis, I will furnish for the record—I do not have it handy right now—the number involved and the number expected to be involved. And, of course, the pension funds have trustees; if you are interested in individual pensioners, I am sure some can be produced.

But I believe that as far as pensioners are concerned, the future solvency of the city is absolutely critical to their own future in terms of receiving pensions.

Senator CURTIS. They are interrelated, there is no question about it.

Senator JAVITS. And so, again, I say that we must bear the burden of proof of demonstrating that these things are essential, and that they are in the pensioner's interest. I could not agree more, and I know that our colleague, Senator Bentsen, has acted with that in mind and will act.

Senator CURTIS. This is a far-reaching principle of the fiduciary arrangement, going clear back to the principle that you cannot borrow your ward's money.

Senator JAVITS. Exactly. I agree with that thoroughly and I see Senator Moynihan is now entering. You have the New York City expert right on the committee, so you will have no dearth of information.

But I will make it my duty, Mr. Chairman, to answer both questions and, with the leave of the Chair, to have them available. Can we take 5 days?

Senator BENTSEN. That is fine.

[The following was subsequently supplied for the record:]

NEW YORK CITY EMPLOYEES' RETIREMENT SYSTEM
New York, N.Y., March 15, 1978.

Re Question to Senator Javits from the U.S. Senate Subcommittee on Private Pension Plans and Employee Fringe Benefits on March 7, 1978.

Mr. RAY SCHMITT,
Congressional Research Service (EPW),
Library of Congress,
Washington, D.C.

DEAR MR. SCHMITT: *Question.* What is the number of pensioners on the New York City pension rolls? How many will there be in ten years?

Answer. This is in response to your request for the number of pensioners on the New York City pension rolls. For the five major actuarial systems, there were 119,000 (one-hundred nineteen thousand) pensioners as of June 30, 1977. It is estimated that there will be 180,000 (one-hundred eighty thousand) pensioners as of June 30, 1987. The number of pensioners includes (1) members who retired because of service, age, ordinary disability or accidental disability and (2) beneficiaries of deceased active or retired members.

At present, the net increase in pensioners, that is, the number added during the year less the number who die is approximately 8,000 (eight thousand) people. It is expected that the net increase will level off slightly beginning in 1982.

The following table shows the number of pensioners for the last five fiscal years and the estimated number of pensioners in 1987.

Pensioners on rolls as of yearend

Fiscal year ended June 30:	*Amount*
1973	85,139
1974	91,067
1975	100,869
1976	107,002
1977	118,883
1987	180,000

Very truly yours,

JONATHAN SCHWARTZ,
Chief Actuary.

Senator JAVITS. Thank you very much.

Senator BENTSEN. Senator Javits, we are very pleased to have you.

Senator JAVITS. Thank you.

[The prepared statement of Senator Javits follows:]

STATEMENT OF SENATOR JACOB K. JAVITS

Mr. Chairman, the investment of the assets of the New York City pension funds is a matter of intense concern to me. The purchase by such funds of the securities of New York City and the Municipal Assistance Corporation (MAC) has staved off bankruptcy for New York City since 1975. Such purchases, however, amounting to about $2.65 billion of long-term notes and comprising approximately 35 percent of these plans' total assets, raise serious questions about fiduciary standards, particularly the "exclusive benefit rule."

Mr. Chairman, in early 1976 the Congress passed Public Law 94–236 which was a companion measure to the Seasonal Financing Act. Public Law 94–236 permits five New York pension funds to purchase MAC and City obligations under an agreement worked out between these plans, MAC, 11 banks, and 4 City sinking funds. The statute provides that such purchases do not violate the Internal Revenue Code's exclusive benefit rule and prohibited transactions provisions. Public Law 94–236 will terminate on December 31, 1978 unless this Committee and the Congress extend its life.

When Public Law 94–236 was passed, I had serious reservations about weakening fiduciary protections for plan participants and beneficiaries. As the Chairman knows, because he was himself a partner in the effort, I labored many years for the passage of the Employee Retirement Income Security Act of 1974 (ERISA). ERISA contains many strong fiduciary provisions for private pension

plans including the prudent man rule, the exclusive purpose (benefit) rule, the asset-diversification requirement and the prohibited transaction rules. Yet, despite my firm commitment to strong fiduciary standards, I supported Public Law 94-236 because I felt it was essential in an emergency situation for the survival of New York City.

The City's fiscal condition has improved since 1975, but it should be clear to all that the City is still in urgent need of federal assistance in respect of its debt. The Administration has presented a generally commendatory first proposal for federal assistance to the City. The proposal calls for long-term federal guarantees of City or MAC securities and the continuation of Public Law 94-236 for City as well as State plans during 1979 through 1982. I support the general thrust of the long-term guarantee proposal as well as the extension of Public Law 94-236. I consider the Administration proposal to be the first step toward an emergency measure which is necessary to save New York from insolvency.

The extension of Public Law 94-236 is a vital element in the consummation of a financial plan for New York City which will accomplish the objective recommended by the President and the Secretary of the Treasury.

To facilitate the further consideration by the Congress of the Administration's proposal, it is essential on this occasion that this extension be in hand; otherwise, it will be impossible to implement the Administration's proposal, or any other plan by the Congress (which will inevitably require investment beyond the December 31, 1978 date in the securities or other indebtedness of New York City, of the Municipal Assistance Corporation or of any other entity designed to serve the same purposes). The reason is that the Administration proposal leaves many aspects of any definitive plan to be negotiated before June 30, 1978 and these negotiations require an ability by the pension plans to agree in advance to certain investments without which the whole proposal fails.

While the Administration plan to save New York City is essential, I believe it will be necessary to materially buttress the proposal, particularly with respect to the role of public pension plans.

Because the participation by the public pension plans is so organic an element of what is to be done, this Committee should act to extend Public Law 94-236 as a threshold implementing action.

I strongly urge this upon the Committee.

Senator BENTSEN. Senator Moynihan, we are delighted you could make it back and I stated at the beginning of this session how much you wanted to be here and had a longstanding commitment. Would you care to make a statement at this time?

Senator MOYNIHAN. Thank you, Mr. Chairman, and thank Cardinal Cook, who provided the helicopter.

Senator BENTSEN. Our next witness is Mr. Jim Brigham who is the director of the New York City Office of Management and Budget.

Mr. Brigham?

STATEMENT OF JAMES BRIGHAM, DIRECTOR, NEW YORK CITY OFFICE OF MANAGEMENT AND BUDGET

Mr. BRIGHAM. Thank you, Mr. Chairman and members of the committee. I would like to thank you for giving the city the opportunity to address the issue of New York City and State employee pension funds' role in plans for New York City's financial recovery.

New York City's pension funds have been the city's principal source of long-term financing in the past 2½ years. Under the 1975 agreement, referred to in Public Law 94-236, pension funds have purchased approximately $1.9 billion of city serial bonds and have agreed to purchase an additional $683 million of serial bonds by June 30, 1978.

The pension funds also hold approximately $886 million of Municipal Assistance Corporation bonds. Upon completing their investment commitments under the 1975 agreement, the pension funds will hold a

total of $3.5 billion in city and MAC securities, which will represent approximately 35 percent of the total assets of the pension funds on June 30, 1978.

The 4-year financial plan submitted to the Secretary of the Treasury on January 20 contemplates that the city pension funds would continue to play a major role in the city's long-term financing. The plan shows how a combination of Federal, State, and local action can bring about the financial stability that is critical to New York's survival.

The linchpin of the plan is the Federal guarantee of securities to be sold to city and State pension funds to finance the city's true capital needs.

It should be recognized that substantial investments by city and State pension funds are critical, not only to the January 20 plan, but to all of the alternative plans which are now being considered. City and State pension funds' assets total approximately $26 billion, just as a major local resource which must play a role in providing the capital which is so necessary for the city.

I should point out that in the 4-year plan the city projected total long-term financing needs over the next 4 years of $5.1 billion. This is a large amount of financing which neither the city nor its financial advisers believe can be raised entirely in the public credit markets.

Thus, the pension funds' key role is a common theme of the plans that have been proposed not only by the city but by the Secretary of the Treasury and Senators Proxmire and Brooke.

If these local resources are to play a major role in the city's recovery, as we believe they should, it is vital to insure that there would be no legal restriction on their ability to do their share.

The extension of Public Law 94-236 to cover investments by the city and State pension funds during the next 4 years would remove one very serious impediment to their participation.

In his testimony before the House Subcommittee on Economic Stabilization last week, Secretary Blumenthal proposed that Congress amend Public Law 94-236 to permit city or State employee pension funds to purchase city or MAC securities during the 1979 to 1982 period.

Now, specifically, we propose that Congress enact an extension to Public Law 94-236 for the 4-year plan period that would permit the city pension funds to invest up to 35 percent of their assets in city or MAC securities and the State pension funds to invest up to 10 percent of their assets.

We wish to emphasize that the city's proposal on pension fund investment is a sound one from the employees' point of view as well as the city's. First of all, the securities proposed to be sold would be backed by city revenues as well as coguaranteed by the Federal and State governments. The city has always paid, on time and in full, the amounts due on long-term city bonds, including those held by the pension funds.

Second, city solvency is a matter of vital concern to both city and State employees and retirees. In view of the close relationship between city and State finances, the city's fiscal health is critical to insuring that both the city and the State are able to make required pension funds contributions and payments in the future.

The 4-year financial plan calls for the city and State pension funds to invest amounts in proportion to their assets. For the city pension funds, this will mean that some of the capital that is already invested in the city and MAC securities will be reinvested as it matures during the next 4 years.

The percentage of city pension fund assets invested in city and MAC securities would actually decline from the 35-percent level projected for next June 30. State pension systems will be asked to invest $1,350 million in city or MAC securities, or 9 percent of their total assets.

This proposed investment program would yield $2.25 billion in funds vitally needed for city capital projects.

It should be recognized that by the final year of the 4-year plan the city will have fully implemented major reforms in pension funding following the recommendations of an independent task force on city pension funds. These reforms now apply to four of the five actuarial pension funds and will require the city to contribute about $160 million more to the pension funds by 1982.

As recommended by the task force, this added cost is being phased in over a 5-year period, beginning with the current fiscal year.

The city is now in compliance with this phasein and the 4-year plan fully provides for the required increases in contributions to the pension fund. Thus, four of the five actuarial pension funds are now on a sound financial footing.

The fifth one is the Fire Department Pension Fund which is now underfunded. The funding of this system has not yet been reformed because of a special problem caused by a statutory 3-to-1 ratio between city contributions and member contributions.

Both the city and the members would have to contribute more to achieve the necessary reforms within the 3-to-1 ratio. The city is willing to do its part if the members will do theirs.

We are discussing this problem with representatives of the members, and we expect to reach an equitable solution in the next few months.

The city is fully aware of its obligations to the pension fund. As evidenced by our implementation of recommended reforms, the city is committed to making contributions on a level sufficient to put the pension funds on a sound actuarial basis. We also recognize that the pension funds have already made substantial investments in the city under the 1975 agreement. These investments have been absolutely essential to the city's financial survival during the past 3 years. They will, as I mentioned before, bring the pension fund's investment in New York City to a level of 35 percent by this June 30.

The investment program proposed under the 4-year plan would actually reduce that level to about 25 percent of their total assets. The new commitments we seek from the pension funds will thus reverse the investment trend started in 1975 and, at the same time, will provide the capital funds required to restore the city's decaying physical plant.

This new commitment is critical to the city's long-term fiscal and economic stability.

Public Law 94-236 gives the pension funds the chance to consider, as they decide how to invest their money, whether the investment will maintain the city's ability to keep the pension fund solvent. That

crucial link between the city and the pension fund, that financial interdependence, continues to exist. What we are asking is that you help New York to help itself. In doing their part, the pension funds will also be helping themselves.

Thank you.

Senator BENTSEN. Thank you, Mr. Brigham.

Our concern, of course, and the jurisdiction of this committee, is that of the pensioners, trying to see that they are safeguarded. Under no prudent man rule that I know of could one expect to invest 35 percent of the securities in the assets of one parent, be it a city or a corporation. Under ERISA, we limit that to 10 percent. Many banks limit it, in their pension funds, to 5 percent.

I am also concerned about the potential conflict of interest that the trustees face when they negotiate for higher wages for current employees, which, in turn, can give problems to the fiscal stability of a city. And I cite the comments from one of your New York papers, and I would like your comments on it.

> In meeting after meeting with fiscal officials, the labor union's consultant has a favorite negotiating position. Everything is related to everything else, he says, a remark city officials take to mean that if the pension funds are pressed to accept large parts of unguaranteed bonds, they could reasonably demand a more generous wage settlement in return.

Mr. BRIGHAM. The city does not view investment in city securities as being linked to the wages of the city employees. I have participated in a number of the negotiations and discussions with the pension fund trustees with respect to their investments, both in city securities and in the restructuring of their investments in MAC securities and city notes, which took place last summer.

In none of those discussions was the question of a tradeoff between wages, investments or investment terms discussed.

I have not seen the reference that you quoted——

Senator MOYNIHAN. Would the Chairman yield?

It is in the Daily News. It is Jack Bigel. Now, come on, Mr. Brigham, you know who said it and you know why he said it and you know that he means it.

Mr. BRIGHAM. Mr. Bigel has not, in fact, been a participant in these discussions that I have referred to. Now, Mr. Bigel is the adviser to a number of the pension funds and he speaks for himself. I can only say that, as far as the city is concerned, this issue is not related.

I might digress for a moment to discuss the 1975 to 1978 period. During this period the city has had very limited labor negotiations because of the Financial Emergency legislation and the wage freeze that was part of that legislation.

Therefore, the first bona fide labor negotiations which have been undertaken since the 1975 agreement was entered into are the ones that are now underway, and I can speak for the city by saying that the issue of pension fund investments versus wages is not one that we consider to be part of the negotiations.

Senator BENTSEN. Mr. Brigham, at what point would you think that the city of New York can have a balanced budget under commonly accepted accounting practice? What is the realistic point?

Mr. BRIGHAM. We have projected in the 4-year plan that the city would have a balanced budget, under generally accepted accounting

principles, by the 1982 fiscal year. That would require the city to close a current gap between its revenues and expenses of approximately $1 billion.

In that plan, the city has identified a number of actions that it would take, including a reduction of its work force and a limitation on its expenses for contractual services and supplies, which would close approximately half that gap.

The remainder would be closed by increased local assistance from the State of New York, and we are projecting that the Federal Government would enact, among other things, welfare reform by the end of that period which would help us close the gap.

Senator BENTSEN. In your comments about the fireman's pension fund, I have been advised that they have a negative cash flow at present. Is that correct?

Mr. BRIGHAM. That is correct.

Senator BENTSEN. I understand that there is to be a 3-to-1 contribution, and it is the city that would be contributing 3 and the present and current employees 1? Is that ratio——

Mr. BRIGHAM. That is correct.

Senator BENTSEN. And the current employees have not agreed to that? Is that the problem?

Mr. BRIGHAM. It is a matter of law, and they have agreed to that currently. However, their 25-percent contribution has been reduced by the city assuming a portion of that 25 percent, which it has done for a number of—well, in fact, all of—the other labor unions.

Senator BENTSEN. When was that done?

Mr. BRIGHAM. That was done, initially, I think, in the early 1960's, and in 1976 the city eliminated half of its assumption of the pension members, or the employees contribution, and it has proposed, as a part of these collective bargaining negotiations——

Senator BENTSEN. And they have resisted that?

Mr. BRIGHAM. No, they did not resist the initial reduction in the city's assumption of their share. The city is now proposing to entirely eliminate its share of the employee's contribution.

What has been at issue is that the trustees of the fund—and, in this case, the fund has eight members, of which four are members of the union—the trustees have refused to allow an increase in the overall level of funding which would require an increase both by the city and by the members.

And the result is that the fireman's pension fund which has potentially the same benefits as the police, requires a much smaller contribution by the firemen than the policemen pay and, in addition, the total contribution is substantially less, approximately 26 percent of salary compared with 40 percent for police.

Senator BENTSEN. Does the fireman's fund have liquid assets to meet the shortfall of cash flow?

Mr. BRIGHAM. Our projections indicate that the investments of the fund could be liquidated and, in fact, some would have to be liquidated next year to meet the benefit payments, and that, unless an increase in funding is agreed to, at the current level of funding the assets of the fund would be exhausted by 1990.

Senator BENTSEN. Senator Curtis?

26-723—78——4

Senator CURTIS. Would you supply for the record some figures on the pension plan as to the different categories of pension plans you have? Now, you have a separate one for firemen and a separate one for policemen, is that right?

Mr. BRIGHAM. That is correct.

Senator CURTIS. And then are all of the other government workers in another plan?

Mr. BRIGHAM. No; the teachers have a separate fund and the members of the board of education have a separate fund and there is a large fund that applies to most city workers called the employees' retirement system that applies to most of the nonunion——

Senator CURTIS. I would like to have you place in the record the different plans that you have according to category and what the level of pension benefits will be paid for someone retiring this year, in each category.

Mr. BRIGHAM. I will do that.[1]

Senator CURTIS. Thank you.

Senator MOYNIHAN. Mr. Brigham, these are oversight hearings, and retrospective by definition. I just want to press you on two things.

First of all, on the question of the state of the pension systems in the city, is it your view that with the exception of the fireman's system, which is a small system, that the systems are actuarially sound?

Mr. BRIGHAM. Yes; it is. That was the intention of the legislation which the city sought and which was passed in the New York State Legislature last summer. This legislation enacted a number of actuarial reforms that were advised by the so-called Shinn Commission, the chairman of which is Richard Shinn, chairman of Metropolitan Life.

Senator MOYNIHAN. I just wanted to hear that from you, because you do know that the Shinn Commission found otherwise, and Prof. Bernard Jump of the Maxwell School in his study of a year ago, was very firmly of the view that the funds were not actuarially sound, owing to the unwillingness to use what he regarded as realistic actuarial tables.

Has that changed?

Mr. BRIGHAM. Yes; it has. Although some of these assumptions were offsetting, some of the actuarial tables that were in use before this legislation were passed dated back as early as 1908. Offsetting that, however——

Senator MOYNIHAN. That was the American Mortality Table——

Mr. BRIGHAM. Of 1908, I think.

Offsetting that was the assumption of interest earnings which was that the funds would earn, on average, 4 percent. So that was a low assumption and the new assumptions now, which were recommended by the Shinn Commission, update the actuarial tables to the ones that are followed by the New York State employment retirement system and update the investment assumption to 5½ percent.

Senator MOYNIHAN. Then the critique that has been made by these two reports, the Shinn Commission and Professor Jump, and which also appeared in the report of the Temporary Commission on City Finances that Judge McGivern chaired and of which Professor Horton

[1] See end of Mr. Brigham's statement.

at Columbia was the executive director that the city pension funds were $8 billion underfunded; do you believe you have met their concerns?

Mr. BRIGHAM. Yes. I should point out that the New York City retirement systems, as many private systems, has a large, unfunded liability. The total accrued liability of the funds is approximately $20 billion. The funds have assets of approximately $10 billion and, over the next 40 years, the city will fund that unfunded accrued liability.

This is not an uncommon feature of pension systems and we are advised that the funding of the unfunded liability over 40 years is sound practice.

Senator MOYNIHAN. There are municipal systems that have no reserves, at all, are there not?

Mr. BRIGHAM. Yes; there are.

We think that the city falls somewhere in the range of acceptable practice as far as the unfunded liability and the method of funding is concerned.

Senator MOYNIHAN. That is a prudent observation somewhere in the range of acceptable practice. Good. You have learned prudence. I thank you very much, sir.

Thank you very much, Mr. Chairman.

Senator BENTSEN. Thank you very much. I am impressed with the fact that the pension programs have tried to correct their unfunded position and that they are using more current and valid investment assumptions in going from the 4 to the 5½ percent.

On the other hand, on the mortality table of 1908, you end up with people living longer——

Mr. BRIGHAM. That is correct, and that changes——

Senator BENTSEN. And that balances off some of that, obviously.

Now, I would also assume that when you talk about $10 billion in current assets that you are not really relating current market value.

Mr. BRIGHAM. That is also correct.

Senator BENTSEN. And if you would provide for the record the valuation on current market values, it would be of help to us.

[See end of Mr. Brigham's statement:]

Senator Curtis?

Senator CURTIS. Just one thing. You stated that these plans are actuarily sound. Could you provide for the record an analysis of this, a cash flow analysis that shows that these pension funds can meet their obligation during the period that they will be holding this New York City debt?

Mr. BRIGHAM. Yes, sir, we will provide that, with the exception of the fire pension funds, which is a matter of current discussions.

Senator BENTSEN. I would say with the exception of the firemen's pension fund, as Senator Moynihan has stated and you have stated, that you have public pension plans around this country in worse shape and in better shape and you are somewhere in between.

Mr. BRIGHAM. Yes, sir.

Senator BENTSEN. Thank you very much.

Mr. BRIGHAM. Thank you, sir.

[The following was subsequently supplied for the record:]

OFFICE OF MANAGEMENT AND BUDGET,
April 6, 1978.

HON. LLOYD BENTSEN,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BENTSEN: During my testimony before your Sub-Committee on March 7, you and Senator Curtis asked me to submit for the record certain information regarding the New York City Pension Systems. I have summarized our responses in the attached exhibits.

Exhibit A.—The market value and par value of the assets of the five major actuarial systems as of December 31, 1977.

Exhibit B.—The projected cash receipts and disbursements of the systems for the Fiscal Years 1979 to 1982.

Exhibit C.—The estimated benefits payable to the members of each system.

Exhibit A sets forth the assets of the City pension funds as of December 31, 1977, on the basis of their par value or cost and their market value. As stated in Exhibit A, the holdings of the funds in City and Municipal Assistance Corporation (MAC) securities are presented at par value. The holdings are so presented because we have no reliable sources for market data with respect to large offerings of City and MAC securities. Transportations in these securities occur daily, but in small amounts. Accordingly, we think that a presentation of the City and MAC holdings of the pension funds valued at their "market" value may tend to overstate the value of these holdings, because such prices are quoted only for relatively small transactions and the pension funds hold hundreds of millions of dollars of these securities. As a guide, however, I have set forth below the pension funds' holdings of City and MAC securities and approximate recent trading prices for comparable securities.

NEW YORK CITY PENSION FUNDS, HOLDINGS OF CITY, AND MAC SECURITIES

	Investment on Dec. 31, 1977 at par value (millions)	Recent market price as a percent of par value
City serial and sinking fund bonds [1]	$2,111	[2] 100.0
MAC bonds	886	[3] 94.5
Other city related holdings	46	[4]
Total	3,043	

[1] Includes $1,780 purchased pursuant to amended and restated agreement as amended.
[2] Price quoted by a major brokerage firm for $100,000 of 9-percent 6-yr bonds, Apr. 6, 1978.
[3] Average of bid-asked quotation for MAC 7½-percent bonds, Apr. 5, 1978, New York Times.
[4] Not available.

The prices set forth above should not be considered to be indicative of prices the pension funds could obtain if they tried to liquidate substantial amounts of their holdings. Because of the large amount of their holdings relative to the size of current market transactions, the pension funds' investments in City and MAC securities are relatively illiquid, and we cannot predict accurately the rate at which the funds might be able to liquidate their holdings or the prices they might obtain in the future.

Senator Curtis asked for a cash flow analysis of the pension funds' ability to meet their obligations during the period they will be holding City debt. Exhibit B indicates that for the FY 1979–1982 period, four of the five pension funds have an excess cash flow which is more than adequate to permit them to make the investments in guaranteed securities proposed in the Four Year Financial Plan. We have not extended our cash flow analysis beyond fiscal year 1982 for two reasons:

1. The analysis indicates that four of the five funds have ample cash flow during each of the four years, and we have not proposed any new investments in City or MAC securities after fiscal year 1982.

2. In subsequent fiscal years the holdings of the funds in City and MAC securities would have a relatively smaller impact on their cash flow because the assets and cash flow of the funds are expected to continue to increase.

With respect to the Fire Pension Fund (Article 1–B), the cash flow analysis indicates that the fund would be in a negative cash flow position beginning in fiscal year 1980 regardless of whether it would make a new investment in City or MAC securities. As I stated in my testimony, the City is now in discussions with representatives of the members to explore methods of putting the Fire Pension Fund on a sound actuarial basis, and we expect to reach an equitable solution in the next few months.

Senator Curtis asked me to provide the retirement allowance payable to current retirees. The Actuary has advised me that a retirement allowance includes a regular pension, a special allowance for increased-take-home-pay and annuity. In general, a member's retirement allowance for service retirement is dependent on a number of variables, including the final salary, years of credited service, any contributions that may be in excess of what is required, sex, and age at retirement. Approximately 10,000 members retire from the various systems annually.

The Actuary is unable to determine the average retirement allowance per retiree. However, Exhibit C sets forth the estimated benefit that would be payable to a member. The estimated benefit assumes that the member retires without electing to receive a reduced allowance in order to provide benefits to a beneficiary should he predecease that beneficiary.

I am enclosing a copy of the report of the Mayor's Management Advisory Board entitled Pensions.[1] Pages 55 to 61 of the report elaborate on the retirement benefits of the various systems.

We will be happy to discuss with you or your staff any questions which may arise upon reviewing the enclosed material.

Very truly yours,

JAMES R. BRIGHAM, Jr.,
Director.

EXHIBIT A

VALUE OF THE ASSETS OF THE NEW YORK CITY RETIREMENT SYSTEM AS OF DEC. 31, 1977

[In millions of dollars]

	New York City employees	Teachers	Board of education	Police article 2	File article 1–B	Total
Par value basis:						
New York City securities [1]	1,423	1,026	56	441	97	3,043
Corporate and miscellaneous bonds	2,124	1,225	100	534	241	4,224
Mortgages and real estate	213	27		20	2	262
Common stock (cost)	553			345	135	1,033
Cash and short-term paper	496	177	9	230	42	954
Total	4,809	[2] 2,455	[2] 165	1,570	517	[2] 9,516
Market value basis:						
New York City securities [1 3]	1,423	1,026	56	441	97	3,043
Corporate and miscellaneous bonds [4]	1,741	972	83	450	201	3,447
Mortgages and real estate [3]	213	27		20	2	262
Common stock [5]	497			306	117	920
Cash and short-term paper	496	177	9	230	42	954
Total	4,370	[2] 2,202	[2] 148	1,447	459	[2] 8,626

[1] Includes securities of the Municipal Assistance Corp. and city related agencies.
[2] Assets held by the comptroller which excludes holdings of the variable annuity funds.
[3] Par value.
[4] Based on Kuhn Loeb Portfolio Review.
[5] Based on closing market prices, Dec. 31, 1977.

Note: Source of data: New York City Office of the Comptroller.

[1] The report "Pensions" was made a part of the committee file. Pages 55 to 61 are attached hereto.

EXHIBIT B

SUMMARY OF NEW YORK CITY RETIREMENT SYSTEMS—PROJECTED CASH FLOW, FISCAL YEARS 1979-82

[In millions of dollars]

	Fiscal year—				
	1979	1980	1981	1982	Total
Receipts:					
City contributions	1,253	1,325	1,405	1,445	5,428
Employee contributions	209	215	223	229	876
Investment income[1]	875	951	955	968	3,749
Total receipts	2,337	2,491	2,583	2,642	10,053
Disbursements:					
Pension payroll	901	1,022	1,107	1,192	4,222
Loans and excess contribution	126	127	127	127	507
Other	163	91	91	91	436
Total disbursements	1,190	1,240	1,325	1,410	5,165
Excess (deficiency) of receipts over disbursements	1,147	1,251	1,258	1,232	4,888
Less investments in guaranteed securities projected in 4-yr financial plan	169	215	258	258	900
Net excess (deficiency) of receipts over disbursements	978	1,036	1,000	974	3,988
Beginning cash balance	1,007	1,985	3,021	4,021	1,007
Ending cash balance	1,985	3,021	4,021	4,995	4,995

[1] Includes both yield on investments and proceeds of maturities.

Source: Office of the Actuary.

EXHIBIT B

NEW YORK CITY RETIREMENT SYSTEMS—PROJECTED CASH FLOW

[In millions of dollars]

	New York City employees	Teachers	Police article 2	Fire article 1-B	Board of education	Total
FISCAL YEAR 1979						
Receipts:						
City contributions	570	404	209	50	20	1,253
Employee contributions	108	48	39	6	8	209
Investment income[1]	440	262	118	38	17	875
Total receipts	1,118	714	366	94	45	2,337
Disbursements:						
Pension payroll	415	248	144	82	12	901
Loans and excess contributions	44	48	25	6	3	126
Other	[2] 126	24	6	2	5	162
Total disbursements	585	320	175	90	20	1,190
Excess (deficiency) of receipts over disbursements	533	394	191	4	25	1,147
Less investments in guaranteed securities projected in 4-yr financial plan	80	53	26	7	3	169
Net excess (deficiency) of receipts over disbursements	453	341	165	(3)	22	978
Beginning cash balance	533	189	240	37	8	[3] 1,007
Ending cash balance	986	530	405	34	30	1,985
FISCAL YEAR 1980						
Receipts:						
City contributions	595	435	225	50	20	1,325
Employee contributions	110	50	40	6	9	215
Investment income[1]	483	281	134	36	17	951
Total receipts	1,188	766	399	92	46	2,491

EXHIBIT B

NEW YORK CITY RETIREMENT SYSTEMS—PROJECTED CASH FLOW—Continued

[In millions of dollars]

	New York City empolyees	Teachers	Police article 2	Fire article 1-B	Board of education	Total
Disbursements:						
Pension payroll	486	268	159	92	17	1,022
Loans and excess contributions	45	48	25	6	3	127
Other	54	24	6	2	5	91
Total disbursements	585	340	190	100	25	1,240
Excess (deficiency) of receipts over disbursements	603	426	209	(8)	21	1,251
Less investments in guaranteed securities projected in 4-yr financial plan	102	68	33	8	4	215
Net excess (deficiency) of receipts over disbursements	501	358	176	(16)	17	1,036
Beginning cash balance	986	530	405	34	30	1,985
Ending cash balance	1,418	888	581	18	47	3,021
FISCAL YEAR 1981						
Receipts:						
City contributions	640	460	235	50	20	1,405
Employee contributions	115	52	41	6	9	223
Investment income (1)	492	280	131	35	17	955
Total receipts	1,247	792	407	91	46	2,583
Disbursements:						
Pension payroll	531	293	174	92	17	1,107
Loans and excess contributions	45	48	26	6	3	127
Other	54	24	6	2	5	91
Total disbursements	630	365	205	100	25	1,328
Excess (deficiency) of receipts over disbursements	617	427	202	(9)	21	1,255
Less investments in guaranteed securities projected in 4-yr. financial plan	122	82	40	6	5	258
Net excess (deficiency) of receipts over disbursements	495	345	162	(18)	16	1,000
Beginning cash balance	1,487	888	581	18	47	3,021
Ending cash balance	1,982	1,233	743	0	63	4,021
FISCAL YEAR 1982						
Receipts:						
City contributions	660	475	240	50	20	1,445
Enployee contributions	117	54	42	6	10	229
Investment income [1]	494	283	136	35	20	968
Total receipts	1,271	812	418	91	50	2,642
Disbursements:						
Pension payroll	566	313	189	107	17	1,192
Loans and excess contributions	45	48	25	6	3	127
Other	54	24	6	2	5	91
Total disbursements	665	385	220	115	25	1,410
Excess (deficiency) of receipts over disbursements	606	427	198	(24)	25	1,232
Less investments of guaranteed securities projected in 4-yr financial plan	122	82	40	9	5	258
Net excess (deficiency) of receipts over disbursements	484	345	158	(33)	20	974
Beginning cash balance	1,982	1,233	743	0	63	4,012
Ending cash balance	2,466	1,578	901	(33)	83	4,995

[1] Includes both yield on investments and proceeds of maturities.
[2] Provides for the transfers of reserves to New York State employees retirement system for court employees transferred to the State.
[3] Cash balance assumes no investment after Dec. 31, 1978, other than the spring 1978 committment of $683,000,000 of New York City bonds.

Source: Office of the actuary.

EXHIBIT C

EXAMPLES OF PENSION BENEFITS

New York City Retirement System: Plan	Earnings	Years of service credit	Percentage accrual rate	Annual retirement allowance
Employees:				
A—Career pension	$17,500	26	55	$9,625
B—Increased service—Fraction	15,000	15	33	4,950
Teacher's Retirement System:				
A	22,000	25	59	12,980
B	19,000	15	31	5,890
Police: 20 yr	21,000	22	53	11,130
Fire: 20 yr	21,000	22	53	11,130

Note: Retirement allowances for members of the board of education retirement system would be computed in the same manner as for members of the employees retirement system.

Source: Office of the Actuary.

EXTRACT OF THE REPORT ENTITLED "PENSIONS"

Summary of retirement benefits [illegible] New York City Retirement System *

Provision	Employees' Retirement System Career Pension Plan	Employees' Retirement System 55-Year-Increased-Service-Fraction Plan	Employees' Retirement System Transit 20-Year Plan	Employees' Retirement System Sanitation 20-Year Plan	Employees' Retirement System Transit Police, Housing Police and Uniformed Correction Force 20-Year Plan
Last amended	1968	1968	1968	1967	Transit Police, 1968; others, 1965
Employees covered	All members of the Employees Retirement System except the Transit and Housing Police Force, Uniformed Correction Officers, Uniformed Sanitation and Transit Operating Employees.	Available to general City employees as an alternative to the Career Pension Plan (This Plan serves, in effect, the interest of the employees who enter service at an age when they are unlikely to come close to 25 years of service by the time they retire.) However, an active member can drop out of the Career Pension Plan and choose this at any time.	Operating employees of the Transit Authority	Uniformed force of the Sanitation Department	Uniformed transit police, uniformed correction force and housing police service.
Alternatives available	55-Year-Increased Service-Fraction Plan	Career Pension Plan	Age 55-[illegible] Plan	Sanitation 25-Year Plan △	Age 55 Plan or 25-Year Plan. △
Service Retirement Allowance Requirements (age/service)	25 years of service and age 55 (or 50 for physically-taxing position) △	55; no minimum service	20 years of service and age 50	20 years of service	20 years of service
Benefit Formulas	For 1st 25 years: retirement allowance of 2.2% of final year's salary for each year of service. For excess years: Total 1. Pension per year of service based on final year's salary of: 1.2%-years before 7-1-68 1.7%-years after 7-1-68 2. Annuity from member contribution account, in excess of required member contribution at end of 1st 25 years; and 3. I-T-H-P Pension for accumulations after 1st 25 years.	Total of: 1. Pension per year of service based on final year's salary of: 1.2%-years before 7-1-68 1.53%-years after 7-1-68 2. Annuity from member contributions. 3. I-T-H-P Pension	For 1st 20 years: retirement allowance of 50% of final year's salary. For excess years: (after 20) 1. Pension for each year over 20 based on highest 5-year average salary of: 1%-years before 7-1-68 1.5%-years after 7-1-68 2. Annuity from member contribution account, in excess of required member contribution at end of 1st 20 years; and 3. I-T-H-P Pension for accumulations after 1st 20 years.	For 1st 20 years: retirement allowance of 50% of final annual salary For excess years: 1. Pension for each year over 20 based on highest 5-year average salary of: 1%-years before 7-1-65 1.5%-years after 7-1-65 2. Annuity from member contribution account in excess of required member contribution at end of 1st 20 years; and 3. I-T-H-P Pension for accumulations after 1st 20 years.	For 1st 20 years: retirement allowance of 50% of final annual salary For excess years: 1. 1.6/3 of average salary in years over 20 for each such year 2. Annuity from member contribution account in excess of required member contribution at end of 1st 20 years; and 3. I-T-H-P Pension for accumulations after 1st 20 years (and after 12-31-66)

△ Positions are designated as "physically-taxing" by the Director of Labor Relations.

△ The 25-year Plan is identical with the 20-year Plan except for a 2% formula in place of a [illegible] formula (per year of service.)

* For members of the System whose date of membership were prior to July 1, 1973.

APPENDIX B-II

APPENDIX B-II

CURRENT RETIREMENT BENEFITS FOR NEW YORK CITY RETIREMENT SYSTEMS*

PROVISIONS	EMPLOYEES' RETIREMENT CAREER PENSION PLAN	55-YEAR-INCREASED-SERVICE-FRACTION PLAN	EMPLOYEES' RETIREMENT TRANSIT 20-YEAR PLAN	EMPLOYEES' RETIREMENT SANITATION 20-YEAR PLAN	EMPLOYEES' RETIREMENT TRANSIT POLICE, HOUSING POLICE AND UNIFORMED CORRECTION FORCE 20-YEAR PLAN
Mandatory Retirement Age	65, with extensions possible to 70	65, with extensions possible to 70.	70, with extensions possible to 80.	70, with extensions possible to 80.	65, or completion of 20 years if later.
Deferred Retirement Allowance Requirement (age/service)	20 years of service. a	15 years of service, including 5 immediately preceding termination.	20 years of service.	None	15 years of service, with at least 5 immediately preceding termination.
Benefits deferred to	Age 55 (or 50 for physically-taxing positions) or when 25 years of service would have been completed, if later.	Age 55	Age 50	——	whenever 20 years of service would have been completed.
Benefit formula	Same as for service retirement	Same as for service retirement	Same as for service retirement	-----	2.5% of final salary per year of service.
Employee Contributions	Schedule of rates based on age at entry and sex, actuarially determined to provide 18-1/3% of final salary (i.e., 1/3 of the 55% allowance) by the time the member is eligible to retire. Payable only until completion of 25 years.	Schedule of rates based on age at entry and sex, actuarially determined to provide at age 55 1% of a five year average salary per year of service. Payable only until age 55 if a pension of at least 25% of salary accrued.	None (contributions in effect prior to July 1, 1970).	Schedule of rates based on age at entry and sex, actuarially determined to provide 25% of the service retirement allowance by the time the member is eligible to retire. Payable only until completion of 20 years.	Schedule of rates based on age at entry and sex, actuarially determined to provide 27.5% of the service retirement allowance by the time the member is eligible to retire. Payable only until completion of 20 years.
Increased-Take-Home-Pay Rates (I-T-H-P)	4%	4%	None (contributions for I-T-H-P Pension in effect prior to 7-1-60)	5%	5%

a. A member with 15 but less than 20 years of service may receive the benefits of vesting if he switches to the Age 55-Increased-Benefit Plan before termination.

*For members of the System whose date of membership were prior to July 1, 1973.

Special Retirement Benefits for New York City Retirement Systems*

Provisions	Police Pension Fund Article 2 20-Year Plan	Fire Department Pension Fund Article 1-B 20-Year Plan	Teachers' Retirement 20-Year Plan	Teachers' Retirement Age 55-Increased-Benefits* Plan	Board of Education Retirement Plan Career Pension Plan or 55-Year Increased-Service-Fraction Plan
Last amended	1963	1940	1970	1970	1960
Employees covered	Uniformed force of the Police Department appointed after March 29, 1940	Uniformed force of the Fire Department appointed after March 29, 1940	Teachers and certain administrative personnel of New York City public schools and of the University of the City of New York.	Same as Teachers 20-Year Plan; this plan is an alternative.	Permanent employees of the Board of Education other than those eligible for the Teachers' System.
Alternatives available	Age 55 Plan or 25-Year Plan. a	25-Year Plan. a	Age 55-Increased-Benefits Plan.	20-Year Plan.	Choice between Career Pension Plan or the 55-Year-Increased-Service-Fraction Plan.
Service Retirement Allowance Requirements (age/service)	20 years of service.	20 years of service.	Age 55 and 25 years of service.	Age 55.	See New York City Career Pension Plan and Increased-Service-Fraction Plan.
Benefit formula	For 1st 20 Years: retirement allowance of 50% of final annual salary. For excess years: 1. 1.67% of average salary in years over 20 for each such year; 2. Annuity from member contribution account in excess of required member contribution at end of 1st 20 years; and 3. I-T-H-P Pension for accumulations after 1st 20 years (and after 10-31-66).	For 1st 20 Years: retirement allowance of 50% of final annual salary. For excess years: 1.67% of average salary in years over 20 for each such year.	For 1st 20 Years: retirement allowance of 50% of final year's salary. For excess years: 1. Pension for each year over 20 based on final year's salary of: 1.2%-years before 7-1-70; 1.7%-years after 6-30-70; 2. Annuity from member contribution account in excess of required member contribution for 1st 20 years (with interest to the earliest payability date). 3. I-T-H-P Pension for accumulations after 1st 20 years.	Total of: 1. Pension per year of service based on final year's salary of: 1.76%-years before 7-1-70; 1.53%-years after 6-30-70; 2. Annuity from member contributions; and 3. I-T-H-P Pension.	Same as New York City Career Pension Plan and Increased-Service-Fraction Plan.

a. The 25-year plan is identical with the 20-Year Plan except for a 2% formula in place of a 2.5% formula (per year of service.)

* For members of the Systems whose date of membership were prior to July 1, 1973.

APPENDIX B-II

[illegible] RETIREMENT BENEFITS FOR NEW YORK CITY RETIREMENT SYSTEMS *

PROVISIONS	POLICE PENSION FUND ARTICLE 2 20-YEAR PLAN	FIRE DEPARTMENT PENSION FUND ARTICLE 1-B 20-YEAR PLAN	TEACHERS' RETIREMENT 20-YEAR PLAN	TEACHERS' RETIREMENT "AGE 55-INCREASED BENEFITS" PLAN	BOARD OF EDUCATION RETIREMENT PLAN CAREER PENSION PLAN OR 55-YEAR INCREASED-SERVICE-FRACTION PLAN
Mandatory Retirement Age	63, or completion of 20 years, if later	65, or completion of 20 years if later.	70	70	65, with extensions possible to 70.
Deferred Retirement Allowances.					
Requirement (age/service)	15 years of service with at least 5 immediately preceding termination.	15 years of service, with at least 5 immediately preceding termination.	20 years of service. (a)	15 years of service, with at least 5 immediately preceding termination.	Same as for New York City Career Pension Plan and Increased-Service-Fraction Plan.
Benefits deferred to:	whenever 20 years of service would have been completed.	whenever 20 years of service would have been completed.	55, or, if later, when 25 years of service would have been completed.	Age 55.	----------
Benefit formula	2.5% of final salary per year of service.	2.5% of final salary per year of service.	Same as for service retirements.	Same as for service retirements.	----------
Employee Contributions	Schedule of rates based on age at entry and sex, actuarially determined to provide 25% of the service retirement allowance by the time the member is eligible to retire. Payable only until completion of 20 years.	Schedule of rates based on age at entry and sex, actuarially determined to provide 25% of the pension and death benefits by the time the member is eligible to retire.	Schedule of rates based on age at entry and sex, actuarially determined so that after 20 years of service, annuity provided by the accumulated contributions would, when payable, equal 22.5% of final year's	Schedule of rates based on age at entry and sex actuarially determined so that by earliest retirement age, annuity provided by the accumulated contributions would provide 1% of last 5 years salary per year of service.	Same as for New York City Career Pension Plan and Increased-Service-Fraction Plan.
Increased-Take-Home-Pay Rate (ITHP)	5%	5%	5%	5%	4%

(a). A member with 15 years of service may receive the benefits of switching if he switched to the Age 55-Increased-Benefits Plan before termination.

*For members of the Systems whose date of membership were prior to July 1, 1973.

APPENDIX B-II

DISABILITY BENEFITS	[illegible] Pension Plan and 55-Year-Increased-Benefit Pension Plan	Police Pension Fund, Article 2; Fire Department Pension Fund Article 1B; Employees' Retirement - Police Forces /a 20 Year Plans	Employees' Retirement Sanitation 20 Year Plan	Employees' Retirement Transit 20 Year Plan	Teachers' Retirement 20 Year Plan and Age 55 Increased-Benefit-Plan
Ordinary (non-service connected)					
Requirements (age/service)	10 years of service	None	a) In title of sanitationman at retirement and 10 years of city service, or b) Holds position in the Uniformed Force of Dept. of Sanitation at retirement with at least 5 yrs. of Sanitation service and membership in [illegible] in 5 years prior to retirement.	10 years of service	10 years of service
Formula	Total of: 1. Annuity from member contributions 2. Increased-take-home pay pensions 3. Pension per year of service based on final year's salary of — [illegible]% for years before [illegible] [illegible]% for years after [illegible]	Retirement allowance Years of Service / Percent of Final Salary: Less than [illegible] — 33 1/3% [illegible] — 50% more than [illegible] — 50% plus [illegible]% for each yr. in excess of [illegible]	Retirement allowance I. (sanit.): [illegible]% per year of service based on 5 year average salary, but not less than [illegible]%. II. (other) Years of Sanitation Service / Percent of Final Salary: Less than 10 — 33 1/3% 10 or more — 50%	Retirement allowance [illegible]% per year of service based on 5 year average salary	Total of: 1. Annuity from member contributions 2. Increased-take-home-pay pensions 3. Pension (whichever is greater a or b): a) [illegible]% of last year's salary, plus [illegible]% for each year over 10, to a maximum of [illegible]% or b) per year of service based on last year's salary: [illegible]% for years before [illegible] [illegible]% for years after [illegible]

/a Transit Police, Housing Police, Correction Officers.

DISABILITY BENEFITS	POLICE PENSION FUND, ARTICLE 2, FIRE DEPT. PENSION FUND, ARTICLE 1B, EMPLOYEES' RETIREMENT - POLICE-FORCES, /b. 20 YEAR PLAN	EMPLOYEES' RETIREMENT SANITATION 20 YEAR PLAN	ALL OTHER PLANS /d.
ACCIDENTAL (service connected) /a.			
Requirements: (age/service)	NONE	NONE	NONE
Formula:	TOTAL OF:	TOTAL OF:	TOTAL OF:
	1. Annuity from member contributions; /c.	1. Annuity from member contributions;	1. Annuity from member contributions;
	2. Increased-take-home-pay Pension;	2. Increased-take-home-pay Pension;	2. Increased-take-home-pay Pension
	3. Pension of 75% of final salary;	3. Pension of 75% of final salary;	3. Pension of 75% of 5 year average salary.
	4. Plus for service in excess of 20 years: 1.67% of average salary in years over 20 for each such year.	4. Plus for service in excess of 20 years: a) 1% of average salary in years over 20 for each such year; and b) 1/2% of average salary for years of sanitation service both in excess of 20 years and after 7/1/67.	

/a. Benefit offset by Workmen's Compensation benefit, except for Sanitation.

/b. Transit Police, Housing Police, and Correction Officers.

/c. For members of Fire Department Pension Fund, Article 1B, contributions exclude interest.

/d. Career Pension Plan and 55-Year-Increased-Service-Fraction-Plan (Employees' and Board of Education Retirement System); 20 Year Plan and Age 55-Increased-Benefits Plan (Teachers' Retirement System); Transit 20 Year Plan (Employees' Retirement System).

APPENDIX B-II

[illegible] BENEFIT PROVISIONS OF NEW YORK CITY RETIREMENT SYSTEMS

PROVISIONS	
DEATH BENEFIT	——————— ALL PLANS ———————
Ordinary (non-service connected)	
Requirements (age/service)	None
Formula	Total of: 1. Payment of member's accumulated contributions /a/ 2. Payment of reserve-for-increased-take-home-pay 3. A lump sum based on salary:
	Years of Service — Amount: Less than 10 — last 6 months salary; 10 or more — last 12 months salary; 20 or more /b/ — twice last 12 months salary
Accidental (service connected) /d/	
Requirements (age/service)	None
Formula	Total of: 1. Payment of member's accumulated contributions /a/ 2. Payment of reserve-for-increased-take-home pay 3. Pension of 50% of 3 year average salary /c/ payable to widow or children under age 18 or dependent parents
Special benefit for members eligible for service retirement (a/k/a/ Death Gamble or preretirement retirement benefit) /e/	
Requirements	Completed minimum age or service requirements to qualify for service retirement on either deferred or immediate payability basis
Formula	"Lump sum equal to actuarial value /e/ of retirement allowance to which member would have been entitled had he retired on the day immediately preceding date of death /f/

/a/ For members of Fire Department Pension Fund, Article 1B, Contributions paid without interest
/b/ not applicable to Police, Fire, Sanitation and Transit 20 Year Plan members
/c/ for uniformed Force members (Police, Fire, Sanitation) annual rate of pay, with provisions for minimum annual rate
/d/ benefit offset by Workmen's Compensation benefit, except for Sanitationmen
/e/ for Uniformed Force members (Police, Fire, Sanitation) lump sum equal to present value of retirement allowance
/f/ for Transit operating employees, the Transit Authority pays the excess of this benefit over the ordinary death benefit paid by the Employees' Retirement System

Senator BENTSEN. Our next witness will be Mr. Sidney Schwartz who is testifying for Mr. Levitt. Mr. Levitt is here. Good. Mr. Levitt, we are pleased to have you.

Mr. LEVITT. Mr. Chairman and members of the subcommittee, may I be permitted now to introduce my companions?

Senator BENSTEN. Please do.

Mr. LEVITT. I have with me Mr. John Mauhs, who sits at my left. He is deputy State comptroller in charge of the retirement system. Mr. Mauhs has also been acting as adviser to the State Commission on Pensions. He has been in that role since its inception, exercising the function of examining and reporting upon the affairs of all of the public pension systems of the State of New York.

The gentleman at my right is Mr. Sidney Schwartz who is the special deputy State comptroller for the affairs of the city of New York. He attends the Emergency Financial Control Board, of which I am a member. He is, indeed, and has been since the inception of that board, the fiscal arm of the board. He has the responsibility of receiving and interpreting for the board the city's fiscal plan and thereafter of monitoring, on a continuous basis, the city's adherence to the fiscal plan.

STATEMENT OF HON. ARTHUR LEVITT, COMPTROLLER, STATE OF NEW YORK, ACCOMPANIED BY: JOHN MAUHS, DEPUTY STATE COMPTROLLER IN CHARGE OF THE RETIREMENT SYSTEM AND SIDNEY SCHWARTZ, SPECIAL DEPUTY STATE COMPTROLLER FOR THE AFFAIRS OF THE CITY OF NEW YORK

Mr. LEVITT. My understanding is that your concern in these hearings is with investments by the five pension funds operated by New York City and particularly with their investment in bonds of the city and of the Municipal Assistance Corporation, or "MAC" as I will call it.

These investments were made with the permission of the Congress as set forth in Public Law 94–236 in 1976. That law exempted the city-operated funds from two requirements of the Internal Revenue Code and regulations: That they be invested for the exclusive benefit of the beneficiaries and that their investments in employer-related securities be stringently restricted.

As a consequence, the trustees of the five city-operated funds hold approximately $2 billion of city securities and $1 billion of MAC securities, entirely or mostly bonds. The total comes to something over one-third of their combined assets.

As I understand it, your primary interest is in determining whether Public Law 94–236 should be extended. That, of course, involves consideration of whether such securities constitute sound investments and of the trustees' rationale for investing in them.

While I am the trustee of two of the State-operated pension funds, I have no role in investments by the city-operated funds. These city-operated funds have their own actuaries, their own boards of trustees, their own investment advisers. The city comptroller is a member of the boards of trustees and I believe has been delegated investment authority from time to time.

State regulation of the city-operated funds is vested in the New York State Insurance Department. They are also subject to continuing scrutiny by the State's Permanent Commission on Public Employee Pension and Retirement Systems—with which Mr. Mauhs is identified, as I said earlier, sometimes called the Kinzel Commission.

In addition, the city-operated funds may be postaudited by the city comptroller and their accounts may be examined by my office.

As to the soundness of the investments, debt service on city bonds is payable each year from a definite, readily ascertainable part of the city's real estate taxes and backed by other city resources. The 4-year plan which the city submitted to the Secretary of the Treasury on January 20 proposes that real estate taxes necessary to pay the annual debt service be deposited with an independent trustee.

While I have seen no draft of State legislation to implement that concept; I must assume it will be prepared and enacted shortly. I assume further that it will be permanent legislation which will extend beyond the 4-year period. It should be noted that debt service has actually been paid on all outstanding city bonds throughout the recent crisis.

Debt service on MAC securities is payable "off the top" of the proceeds of two State taxes on transactions in the city, a sales tax and the stock transfer tax, and from the State's general revenue sharing payments to the city. I have been advised that those sources have provided a coverage of over 1.5 to 0 and have been increasing somewhat.

You will note that the safety of these securities as investments depends on a continuation of the city's economy and tax revenues at their present levels over the life of the bonds. Thus, a fairly long range forecast is involved.

Some investors, who can profit from the tax-free status of the interest, might well be willing to accept the risk inherent in such a forecast. Ordinarily, a pension fund, which gets no benefit from the tax-free status of the interest, could not properly assume that risk.

In, nonetheless, investing in city and MAC bonds, the trustees of the city-operated funds have presumably relied on the unusual circumstances which led to the enactment of Public Law 94-236. Their rationale probably went something like this: The city would be unable to meet its bills if the funds did not buy city or MAC securities; such insolvency would jeopardize the city's ability to continue its contributions to the funds; loss of those contributions would imperil the payments of pensions to retirees now and other city workers when they retire; and therefore, these investments are in the interest of the beneficiaries of the trusts. That is the way the argument runs.

I do not know the extent to which that reasoning has been subjected to factual and legal analysis.

Mr. Chairman, other witnesses whom you have scheduled can no doubt elaborate on the rather general comments I have made. At this point, it occurs to me that it may assist this subcommittee's perspective if I reiterate the substance of what I told a House subcommittee 2 weeks ago about proposals that the State-operated pension funds, of which I am sole trustee, that they invest in city or MAC securities.

Such proposals, I said, were first advanced 2 months ago. At the outset, funds for which I am the trustee were asked for a blanket

commitment to buy some $1 billion of new city bonds or notes. No suggestion was made of any terms which would distinguish them from the bonds and notes which investors in general have steadfastly refused to buy.

It struck me as foolish for explorations of the city's critical problem to proceed further except on the basis of realistic assumptions. I therefore felt it incumbent on me to determine and publicly state whether it would be morally and legally proper for me as a trustee to commit the funds in my trust to such purchases.

I discussed this question at length and in depth with the 11 distinguished members of an investment advisory committee which I had first appointed some years ago.

It was my conclusion, unanimously agreed to by the committee, that the commitment being sought would violate my fiduciary responsibilities as a trustee. Accordingly, I announced that I would not make any such blanket commitment.

At the same time, I left open the possibility of investing in city obligations if, and only if, they were effectively guaranteed by the United States, if the yield equaled the yield available on taxable securities of investment grade, and if the amount comported with prudent portfolio diversification.

In talking of an effective guarantee, I had in mind a guarantee which upon any default of the city would immediately provide cash, or Federal securities paying interest equal to the rate on the guaranteed city obligations, and would extend until the city obligations were redeemed, at maturity or upon an earlier call, or sold.

My reasoning was based upon two factors. The nature of these State-operated pension funds and the duties I bear as a trustee in investing them.

First, I explained that these funds are mistakenly being regarded as State funds, as public funds. They are no such things. The call on them is to meet demands—the call on them now by these people in New York City—is to meet demands that the State do more for the city before any Federal help will be considered.

But they are not State funds, and this is why I have been careful to refer to them as State-operated pension funds, not State pension funds. They consist of money put into trust over many years for the benefit of more than 750,000 present and former employees of the State and of over 2,500 local governmental bodies—local bodies outside of New York City, which has its own separate retirement system, as you have heard this morning.

These 750,000 individuals are the real owners of the pension fund, not the State, not me. So far as the State is concerned, and so far as I am concerned as sole trustee of these funds, they are, in Justice Louis Brandeis' words, "Other People's Money."

Second, my function is to invest those funds as a trustee. The role of trustee is assigned to me by State statutes which have been on the books for over 50 years. Moreover, just 2 years ago, the court of appeals, the highest court in our State, ruled that the members of the retirement system had a constitutional right to have their funds invested in accordance with the fiduciary principles governing the trustees of retirement systems. Those principles are well established in American statutory and common law.

The first of them is that I must invest the funds for the exclusive benefit of the 750,000 beneficiaries of the trust. As you are aware, the Internal Revenue Code itself sets that standard.

The pioneering Employee Retirement Income Security Act of 1974, ERISA, expresses that same thought. The trustee of a private pension fund must invest "solely in the interest of the participants and beneficiaries." While not technically applicable to public pension funds, ERISA stands as a considered declaration of national public policy.

Within the confines of that overriding principle, I must select investments in accordance with what the courts have called the "prudent man rule." As codified in ERISA, that rule commands me to invest in the same way a prudent man in the same circumstances as the average beneficiary—that is, an active or retired government worker—would invest his own money for income after retirement.

Safety of principal and income is obviously one objective. It is recognized as including the soundness of individual investments and adequate portfolio diversification—that is, not putting too many eggs in one basket. In investing for the retirement years of government workers with limited other sources of retirement income, safety has to be the paramount concern.

At present, I said, New York City or MAC bonds and notes may well be attractive to banks and other investors who can accept some risk in return for generous, tax-free income. But they simply do not carry the very high degree of assurance which a pension fund trustee must have that principal and interest will always be paid when due.

It should also be noted that the income of pension trusts is exempt from income taxes and that they therefore get no benefit from the tax-free status of interest on such securities.

I publicly stated this position, and the reasons for it, early in January. Secretary Blumenthal's recommendation last Thursday of bond guarantees running to the pension funds, while leaving some questions still to be answered, is an encouraging recognition of its validity.

Mr. Chairman, my testimony has been addressed to the first and third subjects set forth in your letter to me of March 1. With your permission, Mr. Schwartz is prepared to testify or to answer questions about your second subject, of which he has an intimate knowledge, the financial condition of New York City.

Senator BENTSEN. Mr. Levitt, with that statement of principles, you can handle my pension funds. That is the way I understand the prudent man rule. That is the way I understand the fiduciary relationship. I congratulate you on it.

I think that you have correctly stated, and succinctly stated, the argument for the piece of legislation that allowed the substantial investment in New York securities. Let me ask you, though, what the market is now. You referred to their meeting the maturities, the debt service, but what is the market now for MAC securities? And I am sure that varies some on maturities.

Mr. LEVITT. Well, the market for MAC securities in any such volume as we are talking about here is impossible to say. I follow it almost on a daily basis by reading the offerings in the blue list and I note, to my satisfaction, that MAC securities are offered at a slight premium. I noted too, only yesterday, that the New York City bonds, H of 1979, are offered at a small premium, but if you were to attempt to liquidate

any substantial volume, I suspect that there would have to be a real discount.

Senator BENTSEN. Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, I thank you for an opportunity which I had not expected would come to me, which is to welcome Colonel Levitt to the U.S. Senate Finance Committee. It has been my honor to have been associated with the comptroller for 24 years. I think we went to Albany together. I was a young assistant to Governor Harriman and Arthur Levitt was just elected comptroller. Eras have come and gone and he has persisted with the kind of integrity and solvency that have characterized his pension funds as well. He has been a monument to public trust and private responsibility and it is a privilege to welcome him to this committee.

Mr. LEVITT. Thank you, Senator. Thank you very much.

Senator BENTSEN. Let me say that I did not have the pleasure of knowing Mr. Levitt, but I have been impressed by his testimony.

Senator Curtis?

Senator CURTIS. Mr. Chairman, I have no questions, but I, too, want to commend you upon your pronouncement of sound principles for operation in this area of pensions. It has been good to have you here.

Mr. LEVITT. Thank you, Senator.

[The prepared statement of Mr. Schwartz follows:]

TESTIMONY OF SPECIAL DEPUTY COMPTROLLER FOR NEW YORK CITY, SIDNEY SCHWARTZ

Mr. Chairman and distinguished members of the Subcommittee:

Comptroller Levitt has asked me to present testimony today on the current financial condition of New York City. I would like to briefly discuss the background to this problem.

As you know, in 1975 the City was on the edge of bankruptcy; an enormous deficit, amounting to approximately $2 billion, was expected; and the City had been advised by the financial community that it could not continue to market the City's notes or bonds. At this point, within a span of a few months, the State took two actions. The Municipal Assistance Corporation was established in June 10, and when that Corporation was not deemed sufficient to cope with the problems that had surfaced, the Financial Emergency Act was passed on September 9.

The Municipal Assistance Corporation, or MAC, was established to borrow money for the City by issuing bonds and notes which would have as their funding source certain revenues due the City. These revenues—sales tax, stock transfer tax, and State revenue sharing—were to be set aside by the State in sufficient amounts to fund the MAC debt service requirements. In addition, the MAC statute imposed conditions which were intended to make the City more credit-worthy. The City had to institute certain fiscal reforms, among which were the adoption of a new uniform system of accounting, the gradual elimination of the practice of financing operating expenses through the Capital Budget, and the annual auditing of its operating results. However, even with this earmarking of revenue and these statutory measures for fiscal reform, the public was reluctant to purchase MAC securities, and MAC was not successful in borrowing the amounts sufficient for the needs of the City.

Recognizing that the public's reluctance to invest in MAC securities was based largely on the lack of confidence in both the reliability of information available about the City's finances and the City's ability to put its own house in order, the State passed emergency legislation, primarily the Financial Emergency Act, which established the Emergency Financial Control Board and my office, the Special Deputy Comptroller for New York City. The purpose of the Control Board was to approve a three-year Financial Plan which would return the City to fiscal soundness. Additionally, the Control Board was responsible for monitoring the

City's progress under this plan, and the Board had the authority to require the City to meet the plan. My office was created to assist the Control Board in carrying out its responsibilities. In fulfillment of this purpose my office performs a variety of functions, among them:

(1) We review the revenue estimates of the City and its semi-independent agencies, called "covered organizations" under the Financial Emergency Act.

(2) We monitor the expenditures of the City and its covered organizations.

(3) We review on a quarterly basis the City's compliance with the Financial Plan.

(4) We process contracts requiring major expenditures.

(5) We administer the Control Board's procedures in evaluating collective-bargaining agreements.

(6) We monitor the City's cash management.

Our reports on the City's Financial Plan are also the basis for MAC's evaluation of the financial progress of the City in achieving a balanced budget.

To fund the City's operations during this three-year Financial Emergency period, State and City officials with the agreement of the trustees of the City's pension funds were able to put together a financing package from the following three sources:

(1) Seasonal financing of up to $2.3 billion a year obtained from the Federal government.

(2) Long-term borrowing through the sale of MAC bonds and City bonds to the City pension and sinking funds.

(3) And a bridge loan of $800 million, obtained annually from the State as an advance of State aid.

The State advance and $800 million of the annual seasonal financing substituted for $800 million of additional long-term financing which could not be arranged during this period.

Through the Amended and Restated Agreement, the City pension funds agreed to provide virtually all of the remaining long-term financing requirements.

Last year the Control Board extended the Financial Plan period to cover fiscal year 1979, and requested the City to submit a Financial Plan for that year. The City has submitted this Plan, and my office is currently evaluating it. I believe it probable that the City will achieve a balanced budget (as defined by the MAC statute and related State statutes) in fiscal year 1978, and that the potential budget gap for fiscal year 1979 will be closed by the new City administration. I think these are also the expectations of most people who assume that the City will ultimately be able to manage its own finances. I must note, however, that the State-defined balanced budget still means a fiscal year 1979 budget deficit of over $600 million based on generally accepted accounting principles.

Such principles require the inclusion as a current cost expense items funded through the Capital Budget and the pension accrual which primarily reflects the two-year lag in City contributions. For example, in fiscal year 1979 these amounts are estimated to be in the range of $450 million and $184 million, respectively.

Yet despite these and other efforts made by the State and the substantial efforts made by the City in attempting to accomplish subsantial fiscal reforms in a relatively short period of time, it is not certain how the City will finance its activities subsequent to its fiscal year 1978 when the Federal seasonal loan program is due to expire. There are also no firm commitments from the City's pension and sinking funds, unless further Federal assistance is forthcoming. Last year, for example, the City had to withdraw an offering of about $250 million in short-term notes when that offering received an unfavorable investment rating. In view of these financing uncertainties Comptroller Levitt asked my office to explore various financing alternatives available to the City in fiscal year 1979.

We found that the City's requirement for long-term financing to fund its fiscal year 1979 Capital Budget would be about $1 billion, but might be as low as $800 million; and that the so-called "seasonal requirement" might approximate $1.3 billion but could be substantially less. In large measure the size of the estimated seasonal need depended upon actions the City would and could take both in balancing its budget and in managing its cash during the remainder of fiscal year 1978.

We also outlined possible strategies which illustrate that there is the potential to eliminate the need for short-term borrowing, the State advance, or both in fiscal year 1979. A key element in the ability of the City to reduce or eliminate the need for short-term financing is its ability to advance the receipt of its revenues and to delay payments where such delay could be accomplished without

adverse affect on the payees. We have identified candidates for savings in both areas. We recommended that the City consider accelerating its real estate tax receipts by offering discounts to early payers as it did in 1975. We also recommended that the City change the time of its contributions to its pension funds within the fiscal year.

A copy of my report to Comptroller Levitt (entitled "New York City—Certain Financing Alternatives") is appended as part of the written testimony provided to the subcommittee.

Since it is deemed certain by State and City financial managers that the City will not be able to reenter the capital markets on its own to obtain such financing; in 1978 the City finds itself in a situation remarkably similar to the one it was in in 1975 regarding its cash needs even though from a budgetary point of view there has been dramatic improvement.

As I stated earlier, the City pension funds have played a major role in providing the City with long-term financing during the Financial Emergency period. It is well to ask if they are financially able to continue playing such a role.

In order to determine if the cash flow of the pension funds could accommodate both the delay in pension fund contributions and the purchase of City serial bonds, my office developed cash flow projections by month for the five major pension funds for fiscal years 1979 through 1982. These cash flow projections were developed in aggregate for the five pension systems and we are currently trying to project cash flow for each individual pension fund. I must note that underlying data used in the development of the cash flow projections, obtained form the City Comptroller and from the five pension systems, have not yet been reviewed with the responsible City and pension fund representatives and therefore may be subject to change.

Based on an analysis of all cash receipts and disbursements of the five major pension funds for fiscal year 1977 and the first six months of fiscal year 1978, we have projected ending cash balances for the remaining months in fiscal 1978 and fiscal years 1979 through 1982.

An examination of the monthly projection for those fiscal years shows that the delay in the timing of the City's contribution to the pension funds would not have an adverse effect on the ability of the funds in the aggregate; to meet required payments to beneficiaries during those years; and that the funds would still have substantial amounts available for long-term investment.

Although the City pension funds may have the resources to provide the City with long-term financing, there are questions as to whether they could do so without an extension of Public Law 94-236.

Thus, I would like to express my support for the early enactment of a Federal loan or loan guarantee program. On May 16, 1977, I made a statement before the Senate Committee on Banking, Housing, and Urban Affairs at which time I suggested the Federal Government should consider enactment of a standby loan or loan guarantee program in the event that the City were unable to meet its financing requirements in the market.

The legislation which had been recommended would be for a multi-year period so as to provide assurance to prospective bond buyers that in the event the City were not able to meet all its financing requirements in any one year, the Federal government would either lend or guarantee the difference. The suggestion presumed that any guaranteed loans would not be tax exempt—therefore yielding tax revenues to the Federal Government—and that based on current patterns, the interest would be at a lower rate than the City would otherwise have to pay for long-term money, if it could borrow it.

I believed that if such legislation were timely enacted, its actual use would be limited or that it might never be used. This would be because prospective lenders would need not be concerned whether the City would be able to complete its financing. Coupled with the requirement that the City maintain a balanced budget with appropriate reserves, this should ensure sufficient stability so that the City could plan its finances in an organized way during the next several years. Furthermore, to the extent that the City is able to minimize seasonal borrowing using some of the techniques which were suggested in the financing alternatives report and others which the City may work out, it does not appear that there would be iinsurmountable problems in meeting any residual short-term borrowing requirements provided there were absolute assurance that the City's total financing needs would be met.

In closing, it should be stressed that if Congress were to consider this type of legislation, it should be enacted sufficiently before the close of the City's current fiscal year so that its existence can provide the kind of security to other prospective lenders which will minimize its use.

NEW YORK CITY—CERTAIN FINANCING ALTERNATIVES FOR FISCAL YEAR 1979

SUMMARY FOR THE EMERGENCY FINANCIAL CONTROL BOARD AND THE MUNICIPAL ASSISTANCE CORPORATION

During the three year financial emergency period (ending June 30, 1978) the City will have obtained its outside financing from the following sources:

Seasonal (short term) financing of up to $2.1 billion a year obtained from the Federal Government.

Long term borrowing obtained through the sale of MAC bonds and City bonds to the City pension and sinking funds.

Bridge loan of $800 million obtained annually as an advance of State aid.

However, it has recently been reported that two of these sources may not continue as a City funding source. Representatives of the Federal Government have recommended that no additional Federal loan or loan guarantee programs be made available to the City. In addition, Pension Fund Trustees may object to any further purchase of City securities. Accordingly, State Comptroller Levitt asked this office to explore various financing alternatives for fiscal year 1979. This report comments on some alternatives and suggests possibilities for setting the City on a path independent from seasonal financing.

We believe that a detailed study of the extent to which revenues can be accelerated, and the extent to which the timing of payments can be delayed (in such a manner that the delay would not impair the rights of the payees), should be made by responsible City agencies. Our preliminary review indicated a number of areas that could aid in a solution.

Prepayment of taxes, the City was able to obtain approximately $200 million in real estate tax prepayments in calendar year 1975 in return for an 8 percent discount. We believe prepayment incentives might be repeated, perhaps at a lower discount rate, and that the City should explore the possibility of obtaining other earlier payments in return for a discount. Since the cost of the City's borrowings exceed 8 percent per annum (when it is able to find a lender), this would seem to be a fruitful area for exploration.

Changing the timing of pension funds payments—The City's contribution of about $1.2 billion a year to the various pension funds are made in almost even monthly amounts, although there appears to be no statutory requirement upon the City as to the timing of such payments within a fiscal year. We believe that the timing of the payments could be changed so as to come at year end, and the pension funds reimbursed for any interest income they would otherwise have earned, so that the funds suffer no loss.

Bonding of Capitalized expenditures—By June 30, 1978, the City will have paid a substantial amount for operating expenses in the Capital Budget for which bonds have not been issued. The City Comptroller has indicated that at June 30, 1977, over $1.2 billion of these expenses had not been bonded. Although a bond counsel has questioned whether bonds can be sold to finance these expenditures, we believe the City should investigate the possibility of selling long term debt to financing such expenditures, perhaps through MAc.

Continuation of the State's $800 million annual advance.

ANALYSIS OF CASH FLOW

We conducted a preliminary analysis of cash flow for fiscal year 1979 to estimate roughly in what months, to what degree, and why seasonal financing needs would arise in that year. Our analysis, assuming a balanced budget and financing for the Capital Budget, indicates that if the City started the year with no cash balance, the maximum seasonal financing required during the year to support that year's general fund operations would not exceed $800 million. In addition, sufficient cash would be generated by fiscal year end to pay all charges in later years, such as estimated disallowances of State or Federal Aid, incurred on account of fiscal year 1979. It also appears that the opening balance at the beginning of fiscal year 1979 will be about sufficient to pay all expenses incurred on account of prior years with the possible exception of disallowances.

In a submission to the Federal Government in December 1977, the City estimated that it would require $1.9 billion of seasonal financing. Our study shows that most of the need for this financing in fiscal year 1979 arises not from general fund operations, but to meet the lag between the time Capital expenditures are incurred and the time the City planned to bond them and from the need to bridge the $800 million State advance.

The $800 million State advance is made in the last three months of the City fiscal year and is liquidated during the early part of the succeeding fiscal year. Therefore, if there is not sufficient cash on hand at the beginning of a fiscal year, a need arises to bridge the months between the time the advance is liquidated and the time a new advance is made. The State advance, together with this associated borrowing, thus constitutes a form of long term financing. (This device was used to substitute, in part, for the City's aforementioned inability to issue bonds for expense items charged to the capital budget. This report does not evaluate the extent to which the City would be able to cope with the debt service on such financing.)

FINANCING ALTERNATIVES

This analysis suggests a number of alternatives for copying with the seasonal financial needs of the city in fiscal year 1979. In the text of this report, 8 alternatives for seasonal financing are presented, although other alternatives are possible within the framework we laid out. Each of the alternatives assumes that most or all of the City's Capital Budget expenditures during fiscal year 1979 (including expense items in the Capital Budget) would be financed timely through the sale of bonds. The alternatives include the use of one or a combination of the following: prepaid real estate taxes; deferred contributions to the pension funds, limited short-term borrowing ($600 million or less), bonding of prior year's capitalized expense items, and in two cases a short-term advance from the State.

The report outlines possible strategies which illustrate that there is the potential to eliminate the need for short-term borrowing, the State advance, or both in fiscal year 1979 without recourse to restructing City or MAC debt, or arranging new seasonal borrowings.

The following chart summarizes the alternatives offered in this report and estimates their potential interest savings as against the estimated borrowing costs if the December 1977 City financing plan for fiscal 1979 was implemented.

Action	Alternatives (in billions)							
	1	2	3	4	5	6	7	8
Sale of serial bonds	$0.8	$0.8	$1.0	$1.0	$1.0	$1.0	$1.0	$1.0
State advance	.8	1.2				.8	.6	.8
Prepayment of real estate taxes	.4	4.			.4		.4	
Delay in pension contribution	.9	.9	.4		.8	.6	.6	
Short-term borrowing		.5		.4		.6	.6	
Bonding of prior years capitalized expenses			.8	.8	.7			
Elimination of repayment of State advance								
Potential interest savings (in millions):								
Fiscal year 1979	48.4	40.7	42.5	28.6	35.9	33.8	35.7	.3
Annual basis	81.6	79.8	32.3	28.5	30.4	48.1	54.7	11.3

NEED FOR FEDERAL STANDBY LOAN OR LOAN GUARANTEE PROGRAM

We repeat a recommendation we made before the U.S. Senate Committee on Banking, Housing, and Urban Affairs in May 1977; that the Federal government consider enactment of a standby loan, or a loan guarantee program. The legislation we recommend would provide assurance to prospective buyers that in the event the City were not able to complete its financial requirements in any one year, the Federal Government would either loan or guarantee the difference. We would presume that any guarantee loans would not be tax exempt—therefore yielding tax revenues to the Federal Government—and that interest would be at a lower rate than the City now pays for long term money. The existence of such a program might raise investor confidence to the point where such financing would not have to be used.

NEW YORK CITY—CERTAIN FINANCING ALTERNATIVES FOR FISCAL YEAR 1979

1. INTRODUCTION

By resolution dated June 8, 1977, the EFCB required the City to present a Financial Plan for fiscal year 1979. This plan was presented to the Board on November 21, 1977 but was incomplete in a number of aspects. Most importantly, it defined a budget gap of $249 million,[1] but suggested that the new City ad-

[1] We comment on the reported budget gap in a separate report (EFCB-77-78). This report has been issued in draft form, and will be released later this month.

ministration, which took office on January 1, 1978, should define how the gap will be met. In addition, it did not include a cash flow forecast or a financing plan.

Subsequently, however, the City—in a December 1977 submission of data to the Federal Government in support of a seasonal loan request—forecast its cash flow for fiscal year 1979. This City forecast indicated the following borrowing requirements: an $800 million State advance of fiscal year 1980 aid, the sale of $1 billion of serial bonds, and $1.9 billion of seasonal financing.

2. PURPOSE AND SCOPE

This report on possible financing strategies was prepared at the request of Comptroller Arthur Levitt. He asked this office to define the City's cash needs for fiscal year 1979, and to prepare estimates as to the amount of long term and short term loans which might be required.

During the three year financial emergency period (ending June 30, 1978) the City will have obtained its outside financing from the following sources:

Seasonal (short term) financing of up to $2.1 billion a year-obtained from the Federal government.

Long term borrowing to fund the capital budget (and in fiscal year 1976 and 1977 the deficit)—obtained through the sale of MAC bonds and City bonds to the City pension and sinking funds.

$800 million bridge loan—obtained annually as an advance of State aid.

However, it has recently been reported that two of these sources may not continue as a City funding source. Representatives of the Federal government have recommended that no additional Federal loan or loan guarantee programs be made available to the City, and Pension Fund trustees may object to any further purchase of City securities.

The City's dependence on short term seasonal financing and the interdependence of such loans with other financing arrangements was described in a recent preliminary official statement issued by the City:

"In order to sustain its operations during the first half of the fiscal year while regular installments of State aid are being withheld on account of such advances, the City has relied upon loans under the Federal Credit Agreement, which expires June 30, 1978. If the Congress fails to extend the Federal Seasonal Financing Act, and the City fails to secure an extension of the Credit Agreement or to make other similar financing arrangements, the ability and willingness of the State to make advances may be adversely affected.

"In order to repay loans under the Federal Credit Agreement as required by the end of each of the City's fiscal years (June 30), the City has relied in part upon the $800 million State advances in the last quarter of each City fiscal year."

Accordingly, this report explores various financing alternatives for fiscal 1979 and suggests the possibility of setting the City on a path independent from seasonal financing.

The historic City data used in arriving at the financing alternatives were unaudited. As pointed out by the City, such data may be subject to reclassification or adjustment. In extrapolating and interpreting the information available from different City sources, we made a number of changes to such data as deemed appropriate.

Our estimate assumes, moreover, that the City's financial plan for fiscal year 1978 will be accomplished—namely that the City will end the year with a balanced budget (based on the definition of the MAC statute) and that $280 million will be received from the Mitchell-Lama refinancing. It also assumes that the potential City budget gap for fiscal year 1979 will be closed (again pursuant to the requirements of the MAC statute), and that the estimates for City personal services costs will not exceed the planned amounts. Fiscal year 1978 results varying significantly from the plan will also impact on the cash flow projection alternatives in this report.

In order to confirm the reasonableness of these extrapolations and forecasts, we sent preliminary drafts of this report (containing substantially the same numbers as are used herein) to the City and Municipal Assistance Corporation representatives for comment. Their responses are included as Appendix C of this report.

3. RESULTS OF REVIEW

A major focus of this analysis was to determine whether seasonal financing could be reduced, or even eliminated in its entirety. A study which has such a

thrust must consider both the extent to which revenues can be accelerated, and the extent to which the timing of payments can be delayed (in such a manner that the delay would not impair the rights of the payees). We believe a more detailed analysis of these options should be made by responsible City agencies. However, a preliminary review indicated two major areas which could aid in a solution:

The prepayment of real estate taxes; and

A change in the timing of the City's annual payment to its pension funds.

In addition, a number of other financing arrangements are either necessary or possible:

sale of long term debt to pay for expenditures to be financed through the capital budget in fiscal year 1979.

sale of bonds to finance prior year's capitalized expenditures.

continuation of the State's $800 million annual advance.

Real Estate Tax Prepayment

With the cooperation of the large real estate holders, the City was able to obtain approximately $200 million in real estate tax prepayments in calendar year 1975 in return for an 8 percent annualized discount. We believe this prepayment program might be repeated, perhaps at a lower discount rate. It may be that other taxpayers who are liable for substantial amounts could be persuaded to advance their payments in return for a discount. We suggest the City explore this possibility.

Timing of Pension Fund Payments

The City's payments to the various pension funds of about $1.2 billion a year are made in almost even monthly amounts. Our inquiries indicated that there is no statutory requirement upon the City as to the timing of such payments within a fiscal year. Since the timing of the payments to the pension funds is discretionary, we utilized this flexibility in our suggested financing alternatives. In suggesting this strategy, we also propose that the pension funds be credited with the value of any lost earnings which would result from any change in the payment schedule. We suggest that the City determine if there are any other significant payments during the course of a year that could be deferred to help meet interim cash needs.

Bonding of Capitalized Expenditures

We also note that by June 30, 1978 the City will have paid a substantial amount for capitalized expenditures (operating expenses in the Capital Budget) for which bonds have not been sold. In his fiscal 1977 annual report, the City Comptroller indicated that at June 30, 1977 over $1.2 billion of "expense items in the capital budget" had not been financed by long term debt. Bond counsel has questioned whether bonds can be sold to finance these type expenses (already incurred and to be incurred). Some of the financing alternatives presented in this report assume that the City will be able to sell such bonds. (In a November 28, 1977 official statement of the City indicated "The City is examining various solutions to these problems, [bonding capitalized expenses] including remedial legislation.") The City should investigate the possibility of selling long term debt to finance expenditures charged to the capital budget in fiscal year 1979 and of selling bonds to finance prior years' capitalized expenditures.

Our review indicates that there are a variety of strategies, which include one or a combination of a continuation of the State advance and the financing arrangements discussed above. A number of these alternatives could result in a reduction in the cost of the City's annual borrowings. These are discussed in the following section. Appendix A provides the month by month detail to support the monthly ending cash balances shown in the various alternatives.

4. FINANCING ALTERNATIVES

Alternative No. 1.—The following assumptions are included in this financing plan:

Sale of serial bonds ($800 million).

State advance throughout the City's fiscal year.

Prepayment of Real Estate taxes including June 1978.

Delay in contributions to the Pension Funds.

This plan may require special State legislation because the State Advance overlaps its fiscal years.

CASH FLOW PROJECTIONS, FISCAL YEAR 1979—ALTERNATIVE NO. 1

[In millions of dollars]

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Projected ending cash balance	(264)	(379)	(838)	(719)	(1,253)	(1,683)	(1,443)	(1,825)	(2,032)	(1,608)	(1,825)	(1,596)	(1,596
Financing sources:													
Sale of serial bonds for current needs	250	100	200	100	150								800
State advance					100	250		50	100		100	200	800
Prepayment of real estate tax		(200)	100	(100)	100	(100)						200	0
Delay in pension fund contributions	96	97	96	96	96	96	96	97	96	(289)		(577)	0
Subtotal	82	(382)	(442)	(623)	(907)	(1,237)	(1,447)	(1,678)	(1,836)	(1,897)	(1,725)	(1,773)	4
Beginning balance adjustment	[1]200	546	543	939	1,035	1,381	1,827	1,823	1,970	2,166	1,877	1,977	[1]200
Adjusted ending balance	282	164	101	316	128	144	380	145	134	269	152	204	204

[1] Receipt of the real estate prepayment in June 1978.

Alternative No. 2.—This option consists of the following:
Sale of Serial Bonds to meet current needs ($800 million).
State advances ($800 million).
Reduced seasonal loans ($500 million for one month) used to repay State advances within State fiscal year.
Prepayment of Real Property Tax.
Delay in pension fund contributions.

CASH FLOW PROJECTIONS, FISCAL YEAR 1979—ALTERNATIVE NO. 2

[In millions of dollars]

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Projected ending cash balance	(264)	(379)	(838)	(719)	(1,253)	(1,683)	(1,443)	(1,825)	(2,032)	(1,608)	(1,825)	(1,596)	(1,596)
Financing sources:													
Serial bond sales	250	100	200	100	150								800
State advance					100	250		50	(400)	400	200	200	800
Seasonal loans									500	(500)			0
Real estate prepayment		(200)	100	(100)		100	(100)					200	0
Delay in pension fund contributions	96	97	96	96	96	96	96	97	96	(289)		(577)	0
Subtotal	82	(382)	(442)	(623)	(907)	(1,237)	1,447)	(1,678)	(1,836)	(1,997)	(1,625)	(1,773)	4
Beginning balance adjustment	[1] 200	546	543	939	1,035	1,381	1,827	1,823	1,970	2,166	1,777	1,977	[1] 200
Adjusted ending balance	282	164	101	316	128	144	380	145	134	169	152	204	204

[1] Receipt of a real estate prepayment in June 1978.

***Alternative No. 3.*—Under this plan cash needs are met by the following cash sources:**

Sale of Serial Bonds ($1 billion).
Bonding of prior years' unfunded capitalized expenses ($800 million).
Delay of certain monthly contributions to the employee pension funds.

CASH FLOW PROJECTIONS, 1979—ALTERNATIVE NO. 3

[In millions of dollars]

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Projected ending cash balance	(264)	(379)	(838)	(719)	(1,253)	(1,683)	(1,443)	(1,825)	(2,032)	(1,608)	(1,825)	(1,596)	(1,596)
Financial alternatives:													
State advance													0
Sale of serial bonds for current needs			250		350	300			100				1,000
Bonding prior years capitalized expenses	400	100	100			100		100					800
Delay in pension fund contributions			97		97			97	97	(194)		(194)	0
Seasonal financing													0
Subtotal	136	(279)	(391)	(719)	(806)	(1,283)	(1,443)	(1,628)	(1,835)	(1,802)	(1,825)	(1,790)	204
Beginning balance adjustment	0	400	500	947	947	1,384	1,794	1,794	1,991	2,188	1,994	1,994	
Adjusted ending balance	136	121	109	228	141	111	351	166	156	386	169	204	204

Alternative No. 4.—This option differs from the third alternative in one respect, it substitutes short-term borrowings for the delay in pension fund contributions.

The following are the assumptions for this option:

Sale of Serial Bonds ($1 billion).

Bonding of prior years' unfunded capitalized expenses ($800 million).

Short-term borrowings ($400 million).

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CASH FLOW PROJECTIONS, FISCAL YEAR 1979—ALTERNATIVE NO. 4

[In millions of dollars]

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Projected ending cash balance	(264)	(379)	(838)	(719)	(1,253)	(1,683)	(1,443)	(1,825)	(2,032)	(1,608)	(1,825)	(1,586)	(1,586)
Financing alternatives:													
State advance													0
Sale of serial bonds for current needs			250		350	300			100				1,000
Bonding of prior year's capitalized expenses	400	100	100			100		100					800
Delay in pension fund contributions													0
Seasonal financing			100		100			100	100	(200)		(200)	0
Subtotal	136	(279)	(388)	(719)	(803)	(1,283)	(1,443)	(1,625)	(1,832)	(1,808)	(1,825)	(1,796)	204
Beginning balance adjustment	0	400	500	950	950	1,400	1,800	1,800	2,000	2,200	2,000	2,000	
Adjusted ending balance	136	121	112	231	147	117	357	175	168	392	175	204	204

Alternative No. 5.—This plan assumes the following:
Sale of Serial Bonds ($1 billion).
Delay in pension fund contributions.
Real property tax prepayments.
Limited bonding of unfunded capitalized expense items ($650 million).
This alternative eliminates the need for Seasonal Loans and State advances.

CASH FLOW PROJECTIONS, FISCAL YEAR 1979—ALTERNATIVE NO. 5

[In millions of dollars]

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Projected ending cash balance	(264)	(379)	(838)	(719)	(1,253)	(1,683)	(1,443)	(1,825)	(2,032)	(1,608)	(1,825)	(1,596)	(1,596)
Financing alternatives:													
State advance													0
Sale of serial bonds for current needs		50	200	100	250	100		100	200				1,000
Bonding of prior years' capitalized expenses	100	200				150					100	100	650
Delay in pension fund contributions	96	97	96	96	96	96	96	97		(375)		(385)	0
Seasonal financing													0
Prepayments of real estate tax		(200)	100	(100)		100	(100)					200	0
Subtotal	(68)	(232)	(442)	(623)	(907)	(1,237)	(1,447)	(1,628)	(1,832)	(1,983)	(1,725)	(1,681)	54
Beginning balance adjustment	[1] 200	396	543	939	1,035	1,381	1,827	1,823	2,020	2,220	1,835	1,935	[1] 200
Adjusted ending balance	132	164	101	316	128	144	380	195	188	227	110	254	254

[1] Receipt of a real estate prepayment in June 1978.

Alternative No. 6.—The following are the assumptions included in this Financing Plan:

Sale of serial bonds ($1 billion).

A delay in pension fund contributions for half of the fiscal year.

Short term borrowings ($600 million).

State advances ($800 million) used to repay the seasonal loan and to provide funds for the return of pension fund contributions to the required annual level.

CASH FLOW PROJECTION, FISCAL YEAR 1979—ALTERNATE NO. 6

[In millions of dollars]

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Projected ending cash balance	(264)	(379)	(838)	(719)	(1,253)	(1,683)	(1,443)	(1,825)	(2,032)	(1,608)	(1,825)	(1,586)	(1,586)
Financing alternatives:													
State advances										400	200	200	800
Sale of serial bonds for current needs			250		250	150		250	100				1,000
Delay in pension fund contributions	96	97	96	96	96	96				(192)		(385)	
Seasonal financing	300		100			200				(400)	(200)		
Subtotal	132	(282)	(392)	(623)	(907)	(1,237)	(1,443)	(1,575)	(1,932)	(1,800)	(1,825)	(1,781)	204
Beginning balance adjustment	0	396	493	939	1,035	1,381	1,827	1,817	2,077	2,177	1,985	1,985	
Adjusted ending balance	132	114	101	316	128	144	384	252	145	377	160	204	204

Alternative No. 7.—The following assumptions are included in this financing plan:

Sale of Serial Bonds ($1 billion).
A delay in pension fund contributions.
Short-term borrowings ($600 million).
The use of prepayments of Real Property tax.
Reduced State advances ($600 million).

CASH FLOW PROJECTIONS, FISCAL YEAR 1979—ALTERNATIVE NO. 7

[In millions of dollars]

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Projected ending cash balance	(264)	(379)	(838)	(719)	(1,253)	(1,683)	(1,443)	(1,825)	(2,032)	(1,608)	(1,825)	(1,596)	(1,596)
Financing alternatives:													
State advance										400	200		600
Sale of serial bonds for current needs			300		250	100		250	100				1,000
Bonding of prior years' capitalized expenses													0
Delay in pension fund contribution	96	97	96	96	96	96				(192)		(385)	0
Seasonal financing	100	200		100		100			100	(400)	(200)		0
Prepayments of real estate tax		(200)	100	(100)		100	(100)					200	0
Subtotal	(68)	(282)	(342)	(623)	(907)	(1,287)	(1,543)	(1,575)	(1,832)	(1,800)	(1,825)	(1,781)	4
Beginning balance adjustment	[1] 200	396	493	989	1,085	1,431	1,827	1,727	1,977	2,177	1,985	1,985	[1] 200
Adjusted ending balance	132	114	151	366	178	144	284	152	145	377	160	204	204

[1] Receipt of a real estate prepayment in June 1978.

Alternative No. 8.—This option is generally unrelated to previous alternative cash flow plans. The following are the major components of this plan:

Bonding of unfunded capitalized expense items in April, May and June of fiscal year 1978 ($800 million) and eliminating the receipt of the State advance during the same period of time.

Elimination of the fiscal year 1978 State advance repayment during the first half of fiscal year 1979.

Receipt of a State advance ($800 million) for short term needs in July 1978 and the subsequent repayment in April, May and June 1979.

Sale of Serial Bonds ($1 billion).

This Plan may require special State legislation because the State advance overlaps its fiscal years.

CASH FLOW PROJECTIONS, FISCAL YEAR 1979—ALTERNATIVE NO.

[In millions of dollars]

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Projected ending cash balance	(264)	(379)	(838)	(719)	(1,253)	(1,683)	(1,443)	(1,825)	(2,032)	(1,606)	(1,825)	(1,596)	(1,596)
Financing sources:													
Sale of serial bonds for current needs						250		250	100		300	100	1,000
State advance	800									(269)	(292)	(239)	0
Elimination of fiscal year 1978 State advance repayment	91	90	250	190	160	19							800
Subtotal	627	(289)	(588)	(529)	(1,093)	(1,414)	(1,443)	(1,575)	(1,932)	(1,877)	(1,817)	(1,735)	204
Beginning balance adjustment	0	891	981	1,231	1,421	1,581	1,850	1,850	2,100	2,200	1,931	1,939	
Adjusted ending balance	627	602	393	702	328	167	407	275	168	323	114	204	204

5. ESTIMATED SAVINGS OF FINANCING ALTERNATIVES

The following schedule shows the estimated cost of the city's plan for fiscal year 1979 financing, as submitted to the Federal Governmental in December 1977, compared to estimates of the cost of the Financing Alternatives presented in this report. The city's cash flow forecast includes financing sources which would incur an estimated interest cost of $112.9 million in fiscal year 1979 (cash basis), and an annual cost of $202.7 million. Estimated interest savings available to the city will vary depending on the financing arrangement chosen. Estimated annual savings vary from $11.3 million (using Alternative No. 8) to $81.6 million (using Alternative No. 1). Estimated fiscal year 1979 savings vary from $.3 million (using Alternative No. 8 to $48.4 million (using Alterative No. 1).

A COMPARISON OF INTEREST COSTS FOR FISCAL YEAR 1979 FINANCING USING THE CITY'S FISCAL YEAR 1979 CASH FLOW FORECAST AND FINANCING ALTERNATIVES NOS. 1-8

[In millions of dollars]

Financing alternatives	Interest cost, fiscal year 1979	Interest cost on an annual basis	Estimated savings	
			Fiscal year 1979	On annual basis
City forecast	$112.9	$202.7		
Alternative 1	64.5	121.1	$48.4	$81.6
Alternative 2	72.2	122.9	40.9	79.8
Alternative 3	80.4	170.4	32.5	32.3
Alternative 4	84.3	174.3	28.6	28.4
Alternative 5	78.0	174.8	34.9	27.9
Alternative 6	79.1	154.6	33.8	48.1
Alternative 7	77.2	148.0	35.7	54.7
Alternative 8	112.6	191.4	.3	11.3

6. ANALYSIS OF CASH FLOW

We conducted a preliminary analysis of cash flow for fiscal year 1979 to estimate roughly in what months, to what degree, and why seasonal financing needs would arise in that year. Our analysis, assuming a balanced budget and financing for the Capital Budget, indicates that if the city started the year with no cash balance, the maximum seasonal financing required during the year to support that year's general fund operations would not exceed $800 million (see following table). In addition, sufficient cash would be generated by fiscal year end to pay all charges in later years, such as estimated disallowances of State or Federal Aid, incurred on account of fiscal year 1979.[3] It also appears that the opening balance at the beginning of fiscal year 1979 will be about sufficient to pay all expenses incurred on account of prior years with the possible exception of aid disallowances.

In a submission to the Federal Government in December 1977, the city estimated that it would require $1.9 billion of seasonal financing. It is apparent that most of the need for this financing in fiscal year 1979 arises not from general fund operations, but to meet the lag between the time Capital expenditures are incurred and the time the city planned to bond them, and from the need to bridge the $800 million State advance.

[3] This accumulation results from unpaid encumberances exceeding outstanding receivables and from reserves included in the budget not being utilized until after fiscal year end.

CASH FLOW PROJECTIONS, FISCAL YEAR 1979

[In millions of dollars]

	June	August	September	October	November	December	January	February	March	April	May	June	Subtotal	Post-June
Surplus/(deficit) from operations [1]	(1,256)	854	(279)	193	(59)	(352)	317	(242)	(223)	319	(304)	73	(969)	(155)
Cash needs:														
A/C receivable current year, State	(67)	779	(55)	9	72	(98)	77	44	(138)	(119)	(162)	(278)	64	(64)
A/C receivable current year, Federal	(118)	(151)	(1)	(24)	163	10	(4)	18	(24)	9	11	4	(107)	107
Student fees adjustments	2	1	12	9	0	0	0	0	0	0	(24)	0	0	0
Other current year receivables	6	1	10	6	0	0	(5)	(2)	8	(8)	0	5	21	(21)
Revenues in MAC tax fund	0	0	0	1	0	48	(48)	0	49	(50)	0	0	0	0
Subtotal	(177)	630	(34)	1	235	(40)	20	60	(105)	(168)	(175)	(269)	(22)	22
Cash sources:														
Eliminate capitalized expense	52	52	51	52	52	51	52	52	51	52	52	51	620	25
Eliminate budget deficit	36	36	36	36	36	36	36	36	36	36	36	36	432	36
Encumbrances not warranted	873	(61)	50	68	(79)	(68)	(54)	(76)	(54)	(76)	(101)	(104)	318	(318)
Subtotal	961	27	137	156	9	19	34	12	33	12	(13)	(17)	1,370	(257)
Net flow	(118)	251	(108)	348	(285)	(293)	331	(290)	(85)	499	(142)	325	433	(434)
Beginning balance adjustment	0	(118)	133	25	373	88	(205)	126	(164)	(249)	250	108	0	433
Net ending balance	(118)	133	25	373	88	(205)	126	(164)	(249)	250	108	433	433	(1)

[1] Adjusted for interest cost on State advance

The $800 million State advance is made in the last three months of the city fiscal year and is liquidated during the early part of the succeeding fiscal year.[3] Therefore, if there is not sufficient cash on hand at the beginning of a fiscal year, a cash need exists in the months between the time the advance is liquidated and the time a new advance is made. The State advance, together with this associated borrowing bridge, thus constitutes a form of long term financing.

This financing was needed because as of June 30, 1977 over $1.2 billion of operating expenses in the capital budget had not been financed by long term debt. The lack of financing for these expenditures had resulted in a lower cash balance than would otherwise have obtained and, had created or enlarged cash deficits in certain months within the fiscal year. (This report does not evaluate the extent to which the city would be able to cope with debt service on additional long term debt.)

Thus, if it were not for the factors described above, seasonal financing for general fund operations would not be necessary in fiscal 1979 and perhaps in any other fiscal year so long as the forecast revenue and expenditure patterns continue to obtain.

7. NEED FOR FEDERAL STANDBY LOAN OR LOAN GUARANTEE PROGRAM

On May 16, 1977 we proposed to the U.S. Senate Committee on Banking, Housing and Urban Affairs that the Federal Government consider enactment of a standby loan program in the event that the city were unable to meet its financing requirements in the market. A copy of this proposal is attached as Appendix B to this report.

At that time, this office had not independently reviewed the city's financing requirements, and the estimate of need was the amount used by the city. Now, however, as shown in this report, it appears that the city's financing requirements may be much less. Events, however, continue to indicate that the city will not be able to obtain even this limited financing requirement without some assistance.

Thus, we again propose that the Federal Government enact a standby loan or loan guarantee program. The legislation we recommend would be for a multiyear period so as to provide assurance to prospective bond buyers that in the event the city was not able to complete its financing requirements in any one year, the Federal Government would either loan or guarantee the difference. We would presume that any guarantee loans would not be tax exempt,[4] and that based on current patterns, the interest would be at a lower rate than the city now pays for long term money.

We believe, if such legislation were enacted, that its actual use would be limited or that it might never be used. This would be because prospective borrowers would need not be concerned whether the city would be able to complete its financing. Coupled with the requirement that the city maintain a balanced budget with appropriate reserves, this should ensure sufficient stability so that the city could plan its finances in an organized way during the next several years.

We would suggest that the proposed legislation adequately protect the interests of the Federal Government by providing that the costs of the program be paid for by the city; and if any loan or guarantees are actually made, that the Federal Government have sufficient oversight powers to insure that its interests were fully protected.

[3] We note earlier in this report that this seasonal financing could be provided through several alternatives.

[4] Therefore yielding tax revenues to the Federal Government.

APPENDIX A

CASH FLOW PROJECTION BEFORE CONSIDERATION OF FINANCING REQUIREMENTS, FISCAL YEAR 1979

[In millions]

	July	August	September	October	November	December	January	February	March	April	May	June	Total
Total revenues	$362	$1,753	$808	$1,284	$969	$671	$1,365	$738	$819	$1,347	$645	$1,341	$12,102
Total expenditures	1,619	900	1,092	1,094	1,031	1,024	1,048	980	1,042	1,028	949	1,268	13,075
Surplus/(deficit) from operations	(1,257)	853	(284)	190	(62)	(353)	317	(242)	(223)	319	(304)	73	(973)
Cash needs total	388	1,024	496	299	484	85	99	129	(6)	(116)	(127)	(167)	2,578
Cash sources total	1,036	20	275	192	(24)	(28)	(14)	(47)	(26)	(47)	(76)	(47)	1,214
Net flow	(609)	(151)	(495)	83	(570)	(466)	204	(418)	(243)	388	(253)	193	(2,337)
Beginning balance	309	(300)	(451)	(946)	(863)	(1,433)	(1,899)	(1,695)	(2,113)	(2,356)	(1,968)	(2,221)	309
Net ending balance	(300)	(451)	(946)	(863)	(1,433)	(1,899)	(1,695)	(2,113)	(2,356)	(1,968)	(2,221)	(2,028)	(2,028)
Add: Adjustment for the elimination of the $468,000,000 deficit	36	36	36	36	36	36	36	36	36	36	36	36	432
Subtotal	(264)	(415)	(910)	(827)	(1,397)	(1,863)	(1,659)	(2,077)	(2,320)	(1,932)	(2,185)	(1,992)	(1,596)
Beginning balance adjustment	0	36	72	108	144	180	216	252	288	324	360	396	
Adjusted net ending balance	(264)	(379)	(838)	(719)	(1,253)	(1,683)	(1,443)	(1,825)	(2,032)	(1,608)	(1,825)	(1,596)	(1,596)
Above includes amounts for restricted cash	82	82	38	38	38	38	38	38	38	38	38	38	38

APPENDIX B

(Excerpts from statement of Special Deputy Comptroller for New York City Sidney Schwartz before the United States Senate Committee on Banking, Housing and Urban Affairs, May 16, 1977, 10 a.m.)

Mr. Chairman and distinguished members of the committee:

Thank you for the opportunity to present some of the concerns of my office in connection with the Financial Emergency in New York City. The solution to the emergency may be viewed as having two major aspects. One, the achievement by the city of a balanced budget for its fiscal year 1978 and thereafter; and two, the ability of the city to reenter the nation's capital markets to obtain the financing it will need after June 1978. . . .

There appears to be substantial progress toward meeting the first of the two aspects of the solution to the financial emergency. Thus it seems appropriate now to focus more sharply on the second aspect of the solution: how the city will be able to finance its ongoing operations after fiscal year 1978. Using round numbers, during the emergency period this financing need has averaged about $1 billion a year for long-term capital budget purposes—exclusive of borrowing to finance the city's annual deficits, a maximum of $2.8 billion in recurring seasonal loans, and an annual $800 million "bridge" loan between fiscal years. During the financial emergency period, the long-term financing is being provided by the city's pension and sinking funds and by the Municipal Assistance Corporation; the seasonal requirements are being met by the Federal Government, and the $800 million bridge loan is being made by New York State.

At this time there is no indication of the extent to which the city will be able to meet these financing requirements in the capital markets. It would appear prudent, therefore, to make provisions for the contingency that the city may not be able to obtain such financing. It is in this context that I urge consideration of a Federal loan program that would make available any necessary city financing, but not only on a standby basis. Last February when my comments were solicited on a draft of the General Accounting Office report "Assessment of New York City's Performance and Prospects Under Its 3-Year Emergency Financial Plan," I recommended that the Federal Government consider enacting such a standby loan program.

The suggestion contemplates that the standby program would be in effect both for seasonal financing—the current Federal seasonal loan program is scheduled to expire as of June 30, 1978—and for longer term borrowing needs—basically to finance the city's capital expenditures and those expense items which are being phased out of the Capital Budget pursuant to State and local statutes.

I believe that if such a program were to be enacted early, prospective lenders would feel more confident in buying city obligations with the assurance that the city's full borrowing requirements would be obtained even if the city's aggregate cash needs could not be met in the open market. Such a program would provide a more secure basis for the city's financial management over the next few years. Its enactment sufficiently in advance of the end of fiscal year 1978 should minimize the extent of its actual use, and it could even result in the standby loan never being used. The program should also result in the city's being able to borrow in the public market at lower interest rates than would otherwise be possible. . . .

APPENDIX C

COMMENTS RECEIVED ON DRAFT REPORT

The following are the comments we received on the draft report and our discussion of some of the issues that were raised.

From the EFCB and MAC Executive Directors

We have reviewed your draft report entitled "New York City—Certain Financing Alternatives for Fiscal Year 1979" with considerable interest in light of the serious questions which exist as to the availability of long- and short-term financing for the city after the current fiscal year. As to the specific proposals identified in your report, a number of concerns should be borne in mind, as outlined below:

1. The proposed deferral of the city's payments into its pension funds until the end of the fiscal year may well raise questions about the adequacy of the pensions funds' cash flow and their ability to make timely payments to their beneficiaries. In addition, it should be noted that such a deferral would have the same economic effect as the extension of credit by the pension funds to the city. As such, this proposal may be more usefully considered in the context of the over-all participation of the pension funds in the city's future financing arrangements.

2. The proposal to extend the State advance throughout the city fiscal year not only raises serious statutory and constitutional questions, but would also have a substantial adverse impact on both the State's 1979 budget and its annual cash flow needs. Bonding out the State advance would appear to be a preferable course.

3. In view of the questions raised about bonding for capitalized expenses by the city's own bond counsel, it would appear to be uncertain at best to base any financing plan on the assumption of the city's issuing bonds even based on current capitalized expenses, much less those of prior years. MAC's bonding authority may well have to be used in the event that these legal questions are not satisfactorily resolved.

Ultimately, the sale of bonds in substantial amounts—which your report estimates at between $800 million and $1.8 billion in 1979—will be necessary not only to provide for rational cash flow in fiscal year 1979, but also to provide any framework for long-range fiscal recovery for the city. To that end, representatives of the city, MAC, the Control Board and other interested parties have been discussing a number of possible financing arrangements to provide adequate long-term financing to the city over the next three to four years. We believe that some form of Federal involvement will be essential in order to permit the market to absorb the volume of long-term financing that will be needed. We remain convinced that obtaining such assured long-term financing must be the principal objective to any financing plan; and that once this is accomplished, the options available to the city for meeting its seasonal cash flow needs will greatly increase.

DONALD KUMMERFELD,
Executive Director Emergency Financial Control Board.
EUGENE KEILIN,
Executive Director Municipal Assistance Corporation.

We appreciate the thoughtfulness of the comments made by the EFCB and MAC Executive Directors on our draft, and have considered them in this final report. We offer also the following:

1. Our analysis of the resources available to all city pension funds indicates that during fiscal year 1979 they should have sufficient cash from investments readily convertible to cash at the end of fiscal year 1978 plus on-going investment maturities to accommodate a change in the timing of city contributions. (Of course, this conclusion should be confirmed by the city to the extent that this alternative is used.) As regards the participation of the pension funds in the city's financing arrangements we agree that this is a matter to be decided in the context of an over-all consideration "* * * of possible financing arrangements to provide long-term financing to the city * * *".

2. We recognize that a liquidation of the State advance after the end of the State's fiscal year may require legislation. It may very well be that this would impact unfavorably on the State's budget for fiscal year 1979. We also agree that a preferrable option would be for the city to "bond out the State advance" [5] provided that the additional debt service can be accommodated within the city's financial plan.

3. Our report acknowledges the current uncertainty regarding the city's ability to issue bonds for capitalized expenses and that one alternative might be to use MAC.[5] However, the city has stated that it "* * * is examining various solutions * * * including remedial legislation."

The City Comment Was as Follows

We have reviewed, in detail, your two recent reports entitled "Review of Fiscal Year 1979 Financial Plan," and "New York City—Certain Financing Alternatives for Fiscal Year 1979."

[5] Provided that lenders can be found.

As you know, the city is currently in the process of preparing a new Financial Plan for Fiscal Year 1979, including financing alternatives. The new city plan is due to be released on January 20, 1978.

We appreciate your review of the original plan and your discussion of financing alternatives for fiscal year 1979. Your comments will be considered as they apply, in the development of the new plan.

Sincerely,

ROBERT J. BOTT, *Director,*
Office of Management and Budget.

Senator BENTSEN. The Senate is now in session and we are limited on continuation, but we are very appreciative of the testimony that you have presented, and we thank you very much.

The subcommittee is adjourned.

[Thereupon, at 12:05 p.m., the subcommittee adjourned.]

NEW YORK CITY PENSION PLAN INVESTMENTS

WEDNESDAY, MARCH 8, 1978

U.S. SENATE,
SUBCOMMITTEE ON PRIVATE PENSION PLANS
AND EMPLOYEE FRINGE BENEFITS
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 a.m. in room 2221, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the subcommittee) presiding.

Present: Senators Bentsen, Moynihan, and Curtis.

Senator BENTSEN. This hearing will come to order.

I would ask the panel to take seats here. Roy Schotland, Jack Bigel, Jonathan Schwartz, and Harrison Goldin.

Professor Schotland is a professor at Georgetown University Law Center. Mr. Bigel is pension consultant for the city of New York. Mr. Schwartz is actuary for the New York City pension plans. Mr. Goldin is comptroller for the city of New York.

Gentlemen, if you will limit your testimony to 10 minutes and we will take your full statement for the record. We will have some other members here, hopefully in a little while. Our problem is too many conflicting committee appointments at the same time.

Professor Schotland, if you would lead off, please?

STATEMENT OF ROY SCHOTLAND, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. SCHOTLAND. Thank you, Mr. Chairman.

Despite the complexity of this problem, the facts proving four key points are simple and clear. They show the need for four easily implemented safeguards in any bill extending Public Law 94-236.

Point one. The members of this committee have an unusual, perhaps unique, obligation in this matter. It is not often that protecting the purposes of provisions giving special tax treatment rises to the level of moral duty. Central among Congress safeguards for retirement security are the provisions from which, in 1976, New York City's pension funds were temporarily exempted.

The true question before the committee is not whether the exemption should continue, because some continuation seems unavoidable. The true question is whether the committee will go along with the weakening of protections which were present when the exemptions were first granted but which, in August of last summer, were removed with our Secretary of the Treasury—and I speak as a full supporter of this administration—going along.

26-723—78——7

I will below suggest specifically the kinds of protective safeguards which must be attached to any extension.

These suggestions show how silly is the comment by an administrative spokesman Monday that Senator Bentsen was not relevant in pointing out the recent weakening of safeguards. The administration wants a blank check enacted which adequately protects neither the Federal taxpayer nor the pension funds. The Senator's approach, it seems to me, is aimed at protecting both the taxpayers and the pension funds.

Point 1. If the old people are to be protected, no one will do it if this committee and its counterpart in the other body do not.

The Treasury Department and Senate Banking Committee seem to see this problem of municipal bankruptcy as an occasion for moral bankruptcy. They say, do not involve the Federal taxpayer, let the city pension funds carry the load.

The Human Resources Committee, which is to share with you the concern for retirement security, are not participants in the New York City aid scene.

Who will stand up for the 120,000-odd retirees whose retirement security depends on these funds' solvency?

Point 2. The trustees of the fund include no representative of retired persons, only representatives of the city and current employees. The policeman's fund has four separate representatives for the Patrolman's Benevolent Association plus one for the captains, another for the lieutenants, still another for the sergeants, and yet another for the detectives.

I am not joking. This is the composition of the fund's board. The firemen's fund board is similarly constituted.

But there is no room for even one voice for the retirees in any of these funds.

The five city fund trustees have consistently succumbed to a conflict of interest. They have not acted as trustees but—and here I quote the able gentleman on my left, Mr. Bigel—they have acted "as the leaders of the municipal unions in their capacity as trustees. Everything is related to everything else," he says in current negotiations.

To the union leaders and current employees who control the funds, current wage boosts and job security matter more than pension fund solvency. I request the Chair's permission to insert into the hearing record the front page article on the key role of the funds and the conflict of interest of the trustees, from the New York Times of Saturday, March 4.

Can anyone question that if retiree representatives were on the fund's board, even though they would inevitably be only a minority, the retirees' interests would have been more forcefully advocated? The funds would have secured fuller safeguards.

Point 3. The trustees put their fiduciary obligations beneath the union interests and joined the rest of New York officialdom in gimmicking down the solvency of the funds just as, earlier, the solvency of the city itself was gimmicked down.

Even after the 1975–76 crisis, the funds have been weakened in three critical ways which have been given no public attention. The Treasury Secretary and Banking Committee act as if there had been no gimmickry.

After the enormous role of hidden gimmicks in destroying the city's fiscal soundness, that such people in Washington now go for gimmicks, shows that the law of the Austro-Hungarian generals is still followed: "Carry on with the tactics of the last war, we can only lose another one."

In the opening paragraph of Public Law 94–236, Congress referred to the November 1975 agreement between the fund, the city, MAC, and the banks, an agreement committing the funds to buying about $2.5 billion of city and MAC debt, a sum which no other source would buy, a sum which happened, by coincidence, to come up to about 35 percent of the pension fund assets.

Three important safeguards for the funds were explicit in the 1975 agreement on which Congress explicitly relied. Each of those safeguards was deleted, without substitutes, last summer.

First, at the time of exchange or renewal of city notes, there was to be certification that the city's budget was balanced. That protected the funds from being kept on the sinking ship as it went down.

Since the August 1977 revision, accepted by the Treasury Secretary, the provision is missing.

Second, upon renewal or exchange of city notes, the new notes were to be in a principal amount which shall be reduced annually. This protected the funds from remaining so fully exposed. This provision has also been missing since last summer.

Third, the final maturity date of any city note to be held by the funds shall not be later than July 1986. Similarly, the latest maturity date for MAC bonds was February 1986. The shorter the term of the security, the less the risk, obviously.

These commitments on which Congress relied to reduce the amount of the holdings and limit the maturity to 1986 were expressly noted in the Ways and Means Committee report. But, in fact, instead of the holdings being reduced, by June 30, 1978, the funds will have $3.5 billion in city and MAC securities and, just as the amount of holdings has risen and fallen, the maturities have lengthened.

The funds already hold $150 million of city debt which does not come due until 1988 to 1991. In addition, 30 percent of their MAC debt, $270 million comes due in 1992 and another $560 million, or two-thirds of the MAC debt, comes due in 1995—17-year maturities on extraordinarily risky paper.

In stunning contrast, the latest maturity of the $2.5 billion of city debt which the funds had to take under the November 1975 agreement was November 1976.

So much for the maturity date protection Congress envisioned for the old people when they passed the exemptions to the Tax Code provisions.

Lengthening the maturities is a gimmick that the public has not been told about. To cap it off, the Senate Banking Committee and Treasury Secretary not only ignore the loss of the 1975–76 commitments to protect the funds, but have turned things around by inventing an alleged commitment by the funds to hold, indefinitely, at least 35 percent of fund assets in city and MAC debt, increasing over the next 4 years by $1.3 billion, the dollars so riskily invested as the funds grow—unless they collapse, as the fireman's may this year.

Already, the funds have suffered substantial losses and the beneficiaries' retirement security has been worsened. I request the Chair's permission to insert into the hearing record a recent New York Times letter from William Withers, president of the New York Teachers Pension Association about these injuries.

Senator BENTSEN. Without objection.

Mr. SCHOTLAND. Point four. Last summer, the Secretary allowed the funds to be burdened with longer-term debt on the ground that the new debt would bear higher interest rates, be more marketable and so the funds would be able to reduce their city and MAC holdings.

Now the Secretary proposes to burden the funds with increased debt, as well.

The Secretary seeks a blank check from Congress to write Federal guarantees. The proposal is still very fuzzy, but apparently gives little protection to either the Federal taxpayer or the city pension beneficiary. The Federal taxpayer need not, and should not, be the primary guarantor. Surely the primary guarantor for at least about half of the securities guaranteed should be the State of New York. And if the Federal taxpayer were in the proper role as only ultimate guarantor then the pension funds could secure what they must have: Ultimate Federal guarantees for all the risky local debt they hold, throughout the period that they hold it.

Felix Rohatyn says, "Surely fiscal prudence does not limit one's investments to 100-percent federally guaranteed bonds"; but if the bonds are so risky that they are being dumped into the funds to whatever extent no one else will buy, then surely fiscal prudence demands for such investments nothing less than 100-percent ultimate Federal guarantees.

The Secretary reportedly shows less concern for the fund's solvency than Mayor Koch and city officialdom. Thus, the old people dependent on these funds, increasingly victimized by the conflict of interests of their trustees and the New York City officials, instead of getting help from the more neutral Federal Treasury, find only one more set of officials trying to push off on them as much of the problem as possible.

In conclusion, what should be done? First, extend Public Law 94-236, but experience shows the wisdom of limiting the extension to a maximum of 3 years.

Second, restore the protective provisions of the November 1975 agreements Congress relied upon in making this exemption from Tax Code protection. But this time, put the protective provisions into the legislation itself, lest the 1977 summer wipeout be repeated.

Third, assure with appropriate dates a balanced city budget certified by the EFCB. Assure a commitment to steadily reduce the fund holdings of city and MAC debt. If the city cannot gradually restore its own solvency in far short of 17 years, then the funds, as well as the city, will go broke.

The pension funds can be a temporary crutch for the city, but the longer the crutch is leaned on, the more certain it will break.

Fourth, for the same reason, assure a commitment to a more limited maturity. I suggest 10 years except for the already improperly placed longer term securities.

Next, all State and local debt, including MAC or other agencies' paper imposed on the pension funds—which is, of course, the only reason they are taking it—should be primarily guaranteed by the State of New York, at least to a substantial extent, say 50 percent, and only secondarily, for only the extent necessary, primarily guaranteed by the Federal Government. Both guarantees to operate only in favor of the funds and fully as long as they hold such security.

Next to last, in the effort to reduce gimmickry by making the players more accountable, restore the 1975 practice of publishing in the Congressional Record any amendments to the agreement of November 1975. Require similar publication upon any material change. Include the maturity profile and, instead of waiting to have the Treasury Secretary notify the chairman of this committee and of Ways and Means of any amendments he is allowing, the committee should receive proposed amendments as soon as does the Secretary.

One last recommendation of enormous importance, although perhaps not for enactment. Since the Federal taxpayer is in this sad mess, risks being in much more—and, I think, must be in—Federal representatives should insist that the city funds and the State raise the likelihood that the pension funds will stay solvent. An easy crucial step: Reasonable representation of retirees must be included on every pension fund board involved in trying to rescue the city.

Thank you, Mr. Chairman and Senators.

Senator BENTSEN. Thank you, Professor Schotland. Once again you have given some testimony to this committee that is creative and tries to work out some solutions to the problem we find facing us. And yet you face up to the realities of where we are and what has to be done.

We will get back to you with further questions, but I think we will go ahead with each of the witnesses.

Mr. Bigel?

STATEMENT OF JACK BIGEL, PENSION CONSULTANT, MUNICIPAL LABOR COMMITTEE

Mr. BIGEL. I appreciate, Mr. Chairman, the opportunity to appear before this committee. May I make one correction? I am not appearing here as pension consultant for the city of New York. I am the pension consultant to the Municipal Labor Committee.

Senator BENTSEN. The record will be so corrected.

Mr. BIGEL. The Municipal Labor Committee is an umbrella organization that represents 225,000 employees. I am also speaking for the two unions, not in the Municipal Labor Committee, and those are the Transport Workers Union of America, 40,000 members; and the United Federation of Teachers.

Altogether, Mr. Chairman, these unions represent some 300,000 people who are members of one or another of the five retirement systems. In addition, these unions have, from way back, represented their retired members. They continue to negotiate on behalf of their retired members and, as recently as last week when they met in the first session with the city of New York, one of their requests was for a cost-of-living adjustment for retired members.

They also—and I just want to sketch this out so that, on the record, there is information that the unions represent both the retired pen-

sioners and the active members—operate welfare funds which they have negotiated with their employer, on behalf of their retired members.

Now, Mr. Chairman, I personally have been involved in retirement issues in the city of New York for the past 35 years. Most of the benefit plans that are now available to pensioners are benefit plans in which I have had the honor of representing. The active members of 35 years ago are now the retired members.

I am grateful that, at this hearing, we now also have available to us the services of the distinguished gentleman on my right, Professor Schotland. I welcome his advocacy of our cause and I just wish that I had some of his opportunities and advantages.

With respect to questions before the committee, may I put into focus and into historical perspective the manner in which the assets of the retirement systems were utilized in November 1975. It was a mandate from the White House. I think every member of this distinguished body undoubtedly knew about that. The press carried it in full, and there was no question that the Federal Government, as then constituted, would not participate in any program to meet the requirements of the city of New York, its national city, without a series of demands first being met, and I would like to itemize them for you.

One was participation by the retirement systems.

Two was an absolute requirement that the pension contributions of the active members be increased and the way in which that was done was to remove a benefit then currently being received by all active members known as a 2.5-percent increase take-home pay factor so that every single employee at that time, in essence, took a cut in their take-home pay of 2.5 percent.

There was a demand that the fare be increased, that tuition be imposed in the city university, and all of this done with—not a shotgun, but an .88 millimeter cannon at everybody's head. That is why I appreciate the perspective of Professor Schotland, and I just wish I were not looking down the barrel of that cannon in 1975.

Now, with respect to the actuarial considerations that were given great weight before we made those commitments, I refer you to the first 12 pages of my written statement to this committee. Now, we would not have made that commitment if we had not been convinced in advance that this series of demands being placed on us was, at that time, in the interests of both the active members and the retired members.

You will see, on pages 2 to 12, that at that time we had 72,000 active members eligible for retirement. We had 100,000 retired members. Now that number has increased to about 135,000. There would have been a stampede for retirement. There would have been a run by the members on their money since the members of these systems are on a contributory basis and, by law, are entitled to a 50-percent refund of all of their own contributions at any time. And it was obvious to us that the first victim of the city's bankruptcy would have been the retirement systems themselves.

We would have had enough assets on hand to meet the requirements of the pension payroll. For the next 4 to 5 years, there would have been practically no money available to meet the legal requirements for those members who would have sought retirement.

I made the recommendation in 1975 for the utilization of the assets of the retirement systems. I am proud to acknowledge my authorship. The information contained on pages 2 to 12 was certified by Mr. Schwartz, the actuary for the five retirement systems, my own actuaries and all of the trustees of the retirement systems. We have, in fact, served the needs of the retirees completely while, at the same time, seeking to protect the interests of the active members who are eligible for retirement, and that still numbers about 72,000 people.

Mr. Chairman, I should like to, at this point, indicate to you that the utilization of assets of the retirement system by the city is age-old. It is not a practice that began in 1975. I have submitted to the committee two tables, one of which I think gives you, in one glance, what the practice was since the inception of the systems on an actuarially reserved basis—that is in 1921. What I have presented in this table is what the proportion of city paper in the portfolios in the retirement systems has been since 1952.

[The tables referred to follow:]

TABLE 3.—HOLDINGS OF NEW YORK CITY SECURITIES BY THE NEW YORK CITY RETIREMENT SYSTEMS COMPARED TO TOTAL ASSETS, 1952-53 TO DECEMBER 1977

Fiscal year	Total assets	Holdings of New York City securities	Holdings as a percent of assets
1952-53	$1,290,603,608	$965,805,507	74.8
1953-54	1,476,140,081	1,074,066,777	72.8
1954-55	1,671,044,419	1,155,577,094	68.2
1955-56	1,861,441,938	1,283,133,208	69.9
1956-57	2,074,628,554	1,462,110,463	70.5
1957-58	2,294,397,280	1,642,076,229	71.6
1958-59	2,527,228,010	1,824,347,290	72.2
1959-60	2,769,501,069	1,942,046,400	70.1
1960-61	3,008,417,255	1,976,600,591	65.7
1961-62	3,241,134,436	1,859,618,739	57.4
1962-63	3,512,079,017	1,690,811,238	48.1
1963-64	3,804,965,234	1,537,952,193	40.4
1964-65	4,141,769,389	1,449,402,671	35.0
1965-66	4,516,349,361	1,447,518,659	32.1
1966-67	4,920,773,156	1,446,861,222	29.4
1967-68	5,249,734,778	1,413,921,181	26.9
1968-69	5,481,329,731	1,361,573,402	24.8
1969-70	5,710,663,904	1,270,575,359	22.2
1970-71	5,960,246,051	1,100,779,087	18.4
1971-72	6,247,773,365	1,026,034,455	16.4
1972-73	6,438,818,883	386,673,959	6.0
1973-74	7,264,790,701	330,733,900	4.6
1974-75	7,725,035,898	330,731,898	4.3
December 1977	9,516,965,766	3,043,406,000	32.0

Source: Annual Report of the Comptroller of the City of New York, respective years.

TABLE 4.—CHANGES IN CASH AND SECURITIES HELD BY THE FIVE NEW YORK CITY RETIREMENTS SYSTEMS

[December 1974 to December 1977]

Asset	December 1974		December 1977		Changes	
	Dollar value (millions)	Percent	Dollar value (millions)	Percent	Dollar value (millions)	Percent
New York City securities	165	4.6	3,043	32.0	2,878	+1,744.2
Short-term paper	177	4.9	1,026	10.8	+849	+479.7
Corporate bonds	2,032	56.0	3,467	36.4	+1,435	+70.6
Miscellaneous	421	11.6	761	8.0	+340	+80.8
Mortgages	240	6.6	257	2.7	+17	7.1
Common stock	617	17.0	1,033	10.9	+416	67.4
Cash	(26)	(.7)	(72)	(.8)	NA	NA
Total	3,626	100.0	9,515	100.0	+5,889	+162.4

Note: Including Government mortgages, Canadian bonds, international bank paper, etc.

Source: Office of the New York City Comptroller, Division of Investment Accounting.

Mr. BIGEL. You will note that, as of fiscal 1952, 74.8 percent of all assets of the retirement systems were in city bonds. And I have to tell you, Mr. Chairman, how that practice was stopped. It was stopped by the unions representing the members of these retirement systems.

We thought that this was a foolish kind of investment. City bonds then were extremely attractive. They had a yield of about 2¾ percent and 3 percent, and we thought, at that time, that a much better portfolio mix could be achieved. The trustees of the systems, at that time, were all city officials.

The largest one, the city employee's retirement system, had——

Senator BENTSEN. Mr. Bigel, if you would summarize, your time has expired. We will make your full testimony a part of the record.

Mr. BIGEL. Well, Mr. Chairman, my view is, with respect to Public Law 94–236, we are not even sure that we would like to see it renewed. We have not indicated anywhere—I speak now for the union trustees—that they are going to participate in any funding. They have been barraged. They have been bombarded by the Senate Banking Committee, the Secretary of the Treasury, the mayor of the city of New York, and everybody else. Nobody has really asked them if they will participate, and to what extent.

I said last week at the House Banking Committee that we will not participate without full Federal guarantees, or without full guarantees.

That is the position, not just of the union trustees, but, I believe, all trustees.

Everybody has been talking about the pension funds like they are shooting crap, but nobody has asked the dice themselves what they are going to do. I am glad of the opportunity to tell you straight out that we will not be the bankers of the city of New York. We have been protecting the interests of both our pensioners and the active members, and we will continue to do that.

We are glad to see that we have some people listening in that cause.

Senator BENTSEN. Thank you very much, Mr. Bigel.

We have with us Jonathan Schwartz, actuary for the New York City pension plans.

Mr. Schwartz.

STATEMENT OF JONATHAN SCHWARTZ, ACTUARY, NEW YORK CITY PENSION PLANS

Mr. SCHWARTZ. Thank you, Mr. Chairman.

As the chief actuary of New York City's five actuarily funded retirement systems, I have been asked to comment on the composition of the systems' portfolios and the actuarial soundness of these systems. With reference to the first point, I would like to repeat a statement which I delivered at the annual meeting of the Society of Actuaries which was held in Boston in October 1977.

The statement was as follows:

> The public perception of recent actions by the Trustees of New York City's retirement systems is that the corporate securities from the systems' portfolios have been replaced by city-related securities. This is not the case. On December 31, 1974, immediately before the city's credit was shut off, the retirement systems held roughly $7.7 billion of assets, of which $7.35 billion represented corporate securities and $.35 billion were city-related paper. In other

words, about 4.5 percent of the systems' portfolios was invested in securities of the employer.

As of June 30, 1978, I estimate that these portfolios will amount to roughly $10.75 billion, of which some $3.5 billion will be in city-related securities. Although it is true that the proportion of employer-related securities in the portfolios will have increased to about one-third, the corporate securities will have decreased from $7.35 billion to roughly $7.2 billion, that is, by about 2 percent. In other words, virtually the entire purchase of $3 billion of city-related paper was financed from surplus cash flow rather than from liquidation of corporate securities.

I subsequently summarized my remarks as follows:

In November of 1975, there was a clear and present danger of an imminent City bankruptcy which could have resulted in an indefinite cessation of employer contributions to the city's retirement systems. In that event, it would have been necessary for the retirement systems to immediately begin liquidating assets in order to pay benefits. This would have resulted in a much larger diminution in the systems' corporate securities than the small reduction which has actually occurred.

By way of summation, I think it is fair to say that the Trustees of New York City's retirement systems did not precipitously abandon their fiduciary responsibilities in order to bail out the city. Rather, they made an intelligent choice among several imperfect alternatives; the alternative finally chosen essentially entailed an agreement to invest surplus cash flow in city securities until June 30, 1978 in exchange for a guaranteed surplus cash flow during that period.

I might add that an update of my projection shows that the private-sector portion of the portfolio of New York City's retirement systems actually declined from $7.35 billion as of December 31, 1974 to $7.29 billion as of December 31, 1977, or less than 1 percent and that the city systems should have $480 million on surplus cash flow between January 1, 1978 and June 30, 1978 in order to meet their obligation to purchase $500 million of city securities by June 30, 1978.

In other words, the private sector portion of the portfolios of New York City's retirement systems as of June 30, 1978 will be roughly 99 percent of what it was as of December 31, 1974 immediately prior to the systems having begun to invest heavily in city-related paper.

As regards cast flow, four of the city's five actuarially funded systems have ample cash flow. As of December 31, 1977 the New York City employees retirement system had assets of about $4.8 billion. I project that this system will show a surplus cash flow in fiscal 1979 of $405 million.

The teacher's retirement system, which has assets of $3.2 billion shows a projected surplus cash flow of $290 million. The police pension fund, with assets of $1.6 billion shows a surplus cash flow—projected surplus cash flow—of $150 million.

The board of education retirement system, with assets of about $200 million, shows a projected surplus cash flow of about $20 million.

Further projections done through fiscal year 1982 indicate that the cash flow surplus should increase from year to year in each of the above systems.

As regards the actuarial soundness of the four systems listed above, I would like to read the following excerpt from the report of the pension task force of the mayors' management advisory board, that is, the Shinn report.

It should be emphasized that the existence of an unfunded accrued liability does not necessarily mean the plan is underfunded. A responsibly funded plan will show an unfunded accrued liability until the supplemental liability has been fully amortized. If contributions are made in accordance with cost estimates based

on realistic assumptions, there is, in fact, no underfunding for a continuing plan.

Since contributions to the four above-named systems are being made pursuant to chapter 976 of New York State's Laws of 1977 which enacted into law the recommendations in the Shinn report and since these systems all have very favorable cash flow positions, these systems may certainly be described as actuarially sound.

The fire department pension fund was not covered by the aforementioned legislation and does not have a projected favorable cash flow position. The difficulty with respect to this pension fund is that an actuarial issue and a collective-bargaining issue have become intertwined. Efforts are presently being made to resolve this problem so that the provisions of the Shinn legislation can be extended to the fire fund as well. When this is done, that fund's cash flow difficulties will be resolved and it, too, will be established on an actuarially sound basis.

Thank you, Mr. Chairman.

Senator BENTSEN. Thank you, very much.

Our remaining witness is Harrison J. Goldin, comptroller for the city of New York.

STATEMENT OF HARRISON J. GOLDIN, COMPTROLLER, CITY OF NEW YORK

Mr. GOLDIN. Thank you very much, Mr. Chairman and Senator Moynihan.

I appreciate the opportunity to describe the condition of the New York City employee retirement funds and the reason why these funds and their trustees again require the attention and understanding of the U.S. Congress.

As you are no doubt aware, the actuarial retirement systems of the city of New York consist of five separate systems, each with its own assets and its own board of trustees. Four of these systems are for specific categories of employees: Policemen, firemen, teachers, and education employees other than teachers. The fifth and largest system has a membership of all other city employees, including those who provide such services as health care, sanitation, welfare, and transit.

The five systems had aggregate assets of $9.6 billion as of January 31, 1978, excluding the assets of the teachers variable annuity plan. Aggregating the assets produces a total of some $10.75 billion.

The systems have combined memberships of more than 330,000 employees in the active category and 107,000 in the retired category. The monthly pension checks sent to retirees and beneficiaries in a recent month amounted to $72 million.

These pension checks go to retirees in just about every State in the Union and to foreign countries as well. More than $8 million a month goes to retirees in Florida and a fast-growing $10 million goes to retirees in California.

The comptroller of the city of New York has several roles with respect to the pension funds. One role is to serve as the trustee of the various retirement systems, together with other trustees representing the city government and the public employees. The voting procedures are generally designed to insure that neither the government officials,

acting as a bloc, nor the employee representatives, acting as a bloc, can by themselves achieve passage of a motion without some support from the other side.

The comptroller's second role is to act as the supervisory investment manager of the pension fund assets through a delegation of authority by the trustees. The trustees as a group retain the power to approve or disapprove all transactions. They also select the money managers who make investment recommendations on a regular basis and who direct the actual trading.

It is widely known today that a significant percentage of pension fund assets are invested in the city's own securities. What is not so widely known is that this condition is not a new one for the city of New York.

In the early 1960's, under comptrollers who preceded me in office, the assets of the pension funds were invested twice as heavily as today in city securities. In 1961, for example, when the total assets amounted to $3 billion, some $1.9 billion or 66 percent, was invested in New York City bonds.

In the mid-sixties, there began a program to reduce the holdings of New York City obligations. This was accompanied by heavier investments in corporate bonds and the beginnings of investments in common stocks.

Significant sales of city securities in the portfolios were programed to reduce these holdings. That sale program was pursued aggressively after I became comptroller in 1974 and was calculated to virtually eliminate city securities from portfolios entirely.

By 1974, the corporate bond share of the portfolio was up to 60 percent. Common stocks were 15.5 percent. Investments in the city's own securities were, at that time, down to about 5 percent.

When the fiscal crisis erupted in 1975 shutting the city off from public credit markets, I had been city comptroller for approximately 1 year. I participated in the planning which produced the new State agency, the Municipal Assistance Corp. for the city of New York, which was intended to serve as the financing agency for the city.

We soon learned that even the Municipal Assistance Corporation could not command the amount of credit necessary to meet the city's huge needs for cash.

In the fall of 1975 when the State government itself ran into serious credit problems, the city and State came to the Federal Government for help.

As an active participant at the time, it is my clear recollection that neither the city nor the State proposed or urged that the employee pension funds become, in effect, the bankers and lending agents for the city. No one had an interest in seeing the percentage of pension fund holdings in city paper mount again toward the levels of the early 1960's.

Rather, the city and State at that time requested of the Federal Government a simple program of loan guarantees or outright loans if such were deemed preferable by the administration and Congress. A bill which would have authorized Federal loan guarantees was approved by the House Committee on Banking, Finance and Urban Affairs and was cleared for a vote by the Rules Committee. There was no specific plan, to the best of my knowledge, for a tapping of pension fund assets.

The Ford administration adopted a position in opposition to Federal guarantees of any kind. In the meantime, during hearings before the Senate Committee on Banking, Housing, and Urban Affairs, spokesmen for the city were asked repeatedly why the city did not turn for rescue to its own employee pension funds. The charge was made that the city was seeking what was called a Federal "bailout" while billions of dollars in capital was going untouched in the form of pension fund assets.

While some high officials sought to wash their hands of the city's crisis by pointing to the availability of pension funds, others were actively proposing formal bankruptcy as the best solution.

Finally, as formal bankruptcy drew near in November of 1975, the Federal administration agreed to provide limited seasonal financing help but only as part of a complex and interdependent financing practice involving the city employee pension funds as major lenders in the extraordinary amount of $2.53 billion over the next 3 years.

Now, in 1978, your subcommittee has asked me to comment on the way in which these loans were in the best interest of the city and the pension funds. I am reminded of the Frenchman who was asked what he did during the French Revolution, and he answered, "I survived."

I was not in 1975, nor am I today, a proponent of the use of city pension funds as central financing agents for the city. But when the only alternative to a certain course of action involves a high risk of disaster, the certain course of action may become the only prudent choice, whatever its other drawbacks may be.

Therefore when you ask me, in effect, what good has come of these investments, I can only reply that the city has survived and the pension funds have survived.

Would they have survived without the investment program? I do not know, and I believe further that nobody knows, or ever will know. But prudent men in 1975, including duly-elected officials of the city and State, joined and prodded by high officials of the Federal administration and the Congress, decided that when the possible danger was so great it entailed too high a risk to find out.

It was easy to assert at that time, and perhaps equally easy to assert today, that the pension funds, despite whatever their degree of underfunding, were safe and inviolate in the case of any city bankruptcy. Perhaps this is the case, but it is hard to be absolutely certain when the prospect is one of a desolate, helpless, bankrupt, permanently crippled city unable to maintain normal and essential operations, unable to continue the contributions to the pension funds which are now running at the rate of $96 million a month.

The trustees of the pension systems were, in 1975 and remain today, people of conscience and responsibility, chosen for their capacity to provide leadership and make difficult decisions. They made the agonizing choice to assume a certain investment risk in order to forestall what appeared to be the even greater risk of a calamitous collapse of the city itself, and of its consequent potential effect on the solvency of the pension systems themselves.

Although the city's ultimate recovery, and even its ultimate survival, are by no means assured at this point, the breathing space provided by the financial agreement of 1975 has produced improvements and reforms in the funding of the retirement systems.

As James Brigham, Jr., stated yesterday before this committee, major reforms in pension funding recommended by the commission headed by Richard Shinn of Metropolitan Life Insurance Co., are being implemented on a phased basis.

A longstanding impasse producing a serious underfunding of the fire department pension fund is now the object of intensive efforts toward resolution.

And so I conclude, Mr. Chairman, without turning my attention, as I do in my formal statement, to your second major question which asks me for an overview of the city's financial condition, by referring you to my formal statement and to the reports which are submitted monthly by the city to the U.S. Department of the Treasury, by noting that, although in the abstract it would have unquestionably have been preferable in 1975 for city financing requirements to have been met by other sources, in view of the alternatives available then to the trustees of the pension systems, they made a good faith and prudent judgment consistent with facts then available to them and with their judgment of future conditions that the status of the retirement systems was inextricably intertwined with the viability of the city itself, and determined to embark on the investment program which is the subject of your oversight inquiry.

Thank you very much.

Senator BENTSEN. Mr. Goldin, I think you made as well-reasoned a defense as could be made by the proponents of the viewpoint of the city of New York.

I would ask that the members of the committee on the initial round of questioning limit their questions to 10 minutes.

Mr. Curtis?

Senator CURTIS. I will yield my 10 minutes, because I did not get to hear the testimony.

Senator BENTSEN. Well, I think the answers may provoke some questions from you, Senator.

Let me say first, Mr. Schwartz, in arriving at your actuarial assumptions, what did you use for your investment yield? I understand that you updated the actuarial assumptions.

Mr. SCHWARTZ. That is correct. We are presently using an investment assumption of 5.5 percent.

Senator BENTSEN. What is the yield of the pension fund at the present time?

Mr. SCHWARTZ. It varies system by system. In teachers and the board of education retirement system, it is up around 6¼. New York City employees——

Senator BENTSEN. That is current, overall yield on all of the securities, average yield?

Mr. SCHWARTZ. Correct.

Senator BENTSEN. 6.5 percent.

Mr. SCHWARTZ. With respect to the teachers retirement system and the board of education retirement system.

Senator BENTSEN. All right.

Mr. SCHWARTZ. The New York City employees' retirement system is about 6 percent and under the police pension fund it is around 5.5 percent.

These are the four systems where we have updated the assumptions.

Senator BENTSEN. Now, when you talk about your cash flow on your projections, have you determined whether those cash flow projections are adequate for the entire period of holdings of city debt?

Mr. SCHWARTZ. Senator, when asked to do cash flow projections I make it a practice not to go beyond 5 years simply because I do not think anybody can make intelligent cash flow estimates once you get beyond 5 years. There are just simply too many imponderables involved.

I will say this, that for each of the next 5 years, the systems should have surplus cash flows in each year of the general order of magnitude of between 8 and 10 percent of the assets. Beyond that—I repeat, I make it a practice of not trying to project, simply because I feel there are too many imponderables involved.

Senator BENTSEN. Professor Schotland, I think I agree with you that we are in a position in which there is little choice but to extend Public Law 94-236. I think the objective, although, must be to keep as much discipline as we can on the city of New York and to try to see that we make these pension funds as secure as we can as early as we can.

We had testimony yesterday concerning the balanced budget requirement which was deleted in the 1977 pension agreement because it became superfluous. I cannot look on the question of a balanced budget as becoming superfluous.

In addition to that, we are presented with what is, in effect, two sets of books for the city of New York.

So I would very much agree that we ought to call for a balanced budget in some reasonable period of time with commonly accepted accounting procedures.

Mr. SCHOTLAND. Senator, could I respond to part of that point?

Senator BENTSEN. Yes.

Mr. SCHOTLAND. It seems to me that calling the balanced budget protective provision superfluous is asking the Federal taxpayer not only to get into the situation to a greater extent than he has, and I repeat that I think he must; but also to suspend all commonsense.

If it were superfluous, they would have simply certified as they were required. They would not have taken the provision out. That is just doubletalk.

Senator BENTSEN. Mr. Goldin, would you submit for the hearing record a copy of all the reports to the Treasury that you referred to in your testimony. It would be helpful to this committee.

Mr. GOLDIN. Yes, of course, Senator. We will compile them all and send them to the committee.[1]

Senator BENTSEN. Mr. Bigel, we cited yesterday a comment of city officials—and I would like for you to comment on it—which obviously referred to you and I would like your rebuttal, if there is to be one.

It said:

> In meeting after meeting with fiscal officials, Jack Bigel, labor's consultant, has a favorite negotiating position. "Everything is related to everything else," he says, a remark city officials take to mean that if the pension funds are pressed to accept large parts of unguaranteed bonds, they could reasonably demand a more generous wage settlement in return.

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[1] The reports may be found in the committee's official files.

Would you comment on that, please?

Mr. BIGEL. Well, I would rather comment, Mr. Chairman, than rebut. First of all, there is no quotation in that article attached to anything that I have ever said.

Second, I think that the record of what the labor leaders have done over the last 3 years really answers the question. At no time have any of the labor leaders, or I as their consultant, ever taken the position that unless wage increases are instituted, that investments will not be made.

Let me cite the record. When we entered into the credit agreement of November 26, 1975, I had just recommended and the unions had agreed to a suspension of wage increases; when 65,000 people were in the process of being laid off, we kept on making each and everyone of our commitments.

When we negotiated no-cost contracts in 1976, concomitantly we made the purchase that was in accordance with the seasonal agreement. At no time have any of the labor leaders or I ever brandished the weapon as if it were a weapon, the possibility of withholding any of the purchases that have had to be made.

There was only one time, Senator, when we did that and that was in February 1977. At that time, we said to my distinguished colleague at my left and to the members of the Emergency Financial Control Board, we would not make the commitment due in March of 1977 because the city had no program to meet the requirements of the moratorium decision of our State court of appeals.

About 2 weeks later, the Secretary of the Treasury took identically the same position that we took and, as a result of that—as a result of that, Senator—the city and the unions, with the banks excluded, came up with a program to meet the $983 million that was required by the court of appeals' decision.

I think the record speaks far louder than the statement in the Weisman article.

Now, with respect to buying unguaranteed paper. Senator, let me say with all of the power at my command, I will not recommend that any of the systems purchase any unguaranteed paper.

We have had no discussions with any city official or any official of MAC or anybody else leading anyone to the conclusion that, one, there will be a purchase of unguaranteed paper and two, that the payment for that is an increase.

I reject it categorically. It has never been said. As a matter of fact, in recent meetings with the Secretary of Treasury, this staff, labor leaders and myself, we advised the Secretary that we will not recommend the purchase of unguaranteed paper with or without a wage increase.

Senator BENTSEN. Mr. Bigel, the trustees of a pension retirement system also have the obligation of representing current members of the union. Are they not faced with the conflicting objective, when it comes to the question of working to increase the wage scale of the current members, for the city that is faced with insolvency and, at the same time protecting the beneficiaries of that pension system with the security of the assets when it involves large sums of municipal securities?

You talked to Professor Schotland about how you wished you could look at the problem with more objectivity.

Mr. BIGEL. No. I meant to say I wish I could occupy his seat in the ivory tower.

Senator BENTSEN. All right.

Would it not be better to have, amongst those trustees, people who did not have that kind of a conflicting objective?

Mr. BIGEL. Senator, I had tried in my opening statement to describe that the leaders of unions represent both their retired members and their active members.

Senator BENTSEN. But their objectives are not necessarily the same.

Mr. BIGEL. The objectives are identical. As a matter of fact, the needs—well, Senator, you asked me the question. Let me struggle with it. I do not seek to convince anyone. I can only give you the thinking which is the distillation of my own experience.

It is my experience that 300-odd thousand people do a better collective bargaining job and a better lobbying job in our State legislature with respect to the problems that plague our pensioners the most. Now, let me just describe what that is.

We do not have any escalators in our retirement system unlike the Federal plan or many other plans throughout the country. We have been campaigning for years to get an escalator for the pensioners.

I have to ask you a question. Will pensioners, who number, according to Mr. Goldin's figures, some 107,000—I think it is probably a little bit higher than that—many of whom are now distributed in other States. For instance, we have about 16,000 people living in Florida. Are they in a better position to represent their special interests, which is really how to keep apace with the rise in inflation, are the unions, with their active members and their retirees able to do it?

I can only point to the example of the United Mine Workers where you see a union actively engaged in collective bargaining fighting both for recent retirees and old retirees, and that, as I understand it, is one of the grave issues in that major conflict, and I take my parallel that active union members, knowing that they will be pensioners some day, are in a far better position to campaign actively to take advantage of their combined strength to bring about some required changes than pensioners who may be distributed throughout our State and in other States throughout the union.

Senator BENTSEN. I personally do not think that the analogy is appropriate, because we are discussing situations where you have a question of possible fiscal insolvency by the parent, in effect.

I see that my time has expired, and I yield to the distinguished Senator from New York.

Senator MOYNIHAN. Thank you, Mr. Chairman.

Let me first welcome our witnesses. I would like to begin by an apology, of sorts, to Mr. Bigel. I gave a paper at the White House Conference on Balanced Growth, and I spoke for the Northeast. And in that paper, drawing on the Shinn Commission's report, I remarked that the pension funds of the city of New York were underfunded by the amount of $8 billion, as Mr. Shinn reported.

And I have since learned from the testimony this morning of Mr. Schwartz and perhaps more notably from Mr. Brigham yesterday that this is within the range of accepted practice. That is fine. I am glad to hear that.

I know Mr. Bigel was very upset, because he told an awful lot of people that he was very upset, and they told me.

Mr. BIGEL. That is true.

Senator MOYNIHAN. And I would like to discuss it here.

But now, a couple of points. First of all, I believe this may be, for some of you, the first experience before the Finance Committee. We are a committee of the Senate that has to do with money and we have a fairly cheerful openness about money, because if we do not we will all end up with a little embarrassment.

I would like to know who works for whom here. Mr. Bigel remarked to Mr. Schotland that we have the services of Professor Schotland. Is Professor Schotland a consultant?

Mr. SCHOTLAND. No, sir. I am sure that that was a reference only to the fact that I was speaking at all this morning.

Mr. BIGEL. That was a possibility in future, Senator Moynihan, based on some of the remarks that Professor Schotland made which threw some additional light or shadow over some positions that we took.

Senator MOYNIHAN. Are you offering a monetary reward to Mr. Schotland?

Mr. SCHOTLAND. I suspect that a more likely result of my testimony might be revocation of my Columbia College degree.

Senator MOYNIHAN. Now, let's be clear. Mr. Schwartz, you are the actuary for the New York City pension funds. Are you an employee of the city, sir?

Mr. SCHWARTZ. Well, on the one hand, I get a check every 2 weeks that is signed by the comptroller and the finance administrator, but I work for the boards of trustees of each of the five retirement systems and, as I am sure you are aware, each of these board of trustees——

Senator MOYNIHAN. Do not be sure I am aware of anything.

Mr. SCHWARTZ. Each of these board of trustees comprises both employer representatives and employee representatives so, for example, in the largest system, the New York City employees retirement system, the board of trustees comprises the board of estimates plus the heads of the three largest unions whose members are covered by the New York City retirement system.

In other words, DC 37——

Senator MOYNIHAN. Right. Who pays your salary?

Mr. SCHWARTZ. Well, once again, since I am the actuary of five different retirement systems, my salary is apportioned. I am a part-time employee of several different retirement systems. Part of my salary shows up in the teachers retirement system budget, part of it in the police department budget and so on.

Senator MOYNIHAN. Is your salary a matter of public record?

Mr. SCHWARTZ. I guess it is.

Senator MOYNIHAN. Mr. Bigel, you are not a trustee?

Mr. BIGEL. No; I am not, sir. I have an actuarial and an economic consulting firm known as program planners——

Senator MOYNIHAN. This is the logo?

Mr. BIGEL. That is the logo.

I represent many of the unions, practically all of the unions individually and I am also the consultant to the Municipal Labor Committee. I am also their observer on the Emergency Financial Control Board.

Senator MOYNIHAN. Is your compensation a matter of public record?

Mr. BIGEL. Just in my tax return.

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Senator MOYNIHAN. That is not yet a public record.

Mr. BIGEL. Well, then it is not a matter of public record.

Senator MOYNIHAN. I have one question, because I was struck by your statement that the unions were not sure—I hope the difference is that when you say they are not sure they want to see this bill renewed, are you referring to the trustees or to the union leaders, or to whom?

Mr. GOLDIN. Many of the union leaders are trustees of the systems. For instance, in the city employees' retirement system, the largest system, the three union trustees specified by State law are Victor Gotbaum, who is the head of District Council 37; Barry Feinstein, who is the head of Teamster Local 237; and John Lane, who is the head of the Transport Workers Union of America.

Senator MOYNIHAN. Are they the only trustees?

Mr. BIGEL. No. Then there are—then the board of estimates sits as trustees and they all have separate votes. For instance, the comptroller has one vote, the mayor's representative has one vote, et cetera.

Senator MOYNIHAN. All right. Now, when you say "they," whom are you talking about? They in their different roles?

Mr. BIGEL. Everybody occupies different roles. The comptroller is both the comptroller and, at the same time, a trustee. Gotbaum is a labor leader at the same time he is a trustee.

When I said "they," I was referring to the trustees of all the funds who represent the unions.

Senator MOYNIHAN. You are saying, "they are not sure they want this bill renewed."

Mr. BIGEL. I say that, Senator, because we have reached no determination that additional investments are prudent unless and until there are full Federal guarantees.

Senator MOYNIHAN. But when you say that they are not sure they want it renewed, it means they are not sure, but they would just as soon see the city of New York go bankrupt.

Mr. BIGEL. Now, you know, Senator, based on the record that that would be an unfair conclusion since you know, as well as I, that the sole banker for the city of New York for 3 years has been the unions, that these unions have given up over $636 million in wages and in fringe benefits. You know the record as well as I do.

I do know that the pistol of bankruptcy is being waged once again and all we are asking, if we are to make any additional investments, is to have those investments guaranteed. And I do not think that is too much to ask.

If you are asking me, will they make the investments in the absence of guarantees, then I have to say to you, Senator, that they are persuaded by statements made by Professor Schotland, by other actuaries in the field. There is a subcommittee report pending in the House Labor Committee which is extremely critical of these investments.

They are persuaded by all of these criticisms, they take them to heart. They also want to be sure that the assets will be fully protected.

I think that you would join with them in that feeling.

Senator MOYNIHAN. Not me. I would be terrified to be on one of those boards.

I want to ask Professor Schotland just a quick question. My time is running out, but we might come around for a second round.

It is not possible that a professor of law of Georgetown University to come before this committee and say that, with respect to the city, that the trustees represent only current employees and there is an acute conflict of interest.

That is a charge of gravity. Conflict of interest carries criminal penalties, does it not?

I am not saying that you make that suggestion, but I, as a Senator from the State of New York, I cannot hear that and just say, aha, that is interesting.

Mr. SCHOTLAND. Senator, I appreciate your seeing that I intended it to be a statement of gravity. I did not intend and would by no means agree that there ought to be criminal—indeed, I do not believe there ought to be even civil liabilities—on these trustees, and under the present law, I do not believe there could be—on these trustees for what they have done. I entirely agree that they faced the gun and I personally think they took the route they had to take. In 1975 they got guarantees that the Treasury Secretary and New York got rid of last summer and I want to know why, with the gun not around, we cannot get guarantees now.

That is what I meant.

Senator MOYNIHAN. My time has expired, but we will come back to this. Let me make clear I do not think anybody is guilty of anything. I do not know. I am just trying to find out——

Mr. SCHOTLAND. Senator, I am trying to say that I believe you and your colleagues in this body represent all of the United States, but you are not picked by all of the United States, you are picked by your own State.

Similarly, the trustees are not picked by all of their constituencies, and I reject the kind of 19th century paternalism which seems to me to predate collective bargaining, that the employer will take care of the employees and the current employees will take care of the retirees. I do not see it.

Senator BENTSEN. Senator Curtis?

Senator CURTIS. One question to Mr. Schwartz. Have you updated the mortality and salary scale assumptions of the plans?

Mr. SCHWARTZ. In all of the five systems, yes. Basically, the aforementioned recommendations of the Shinn report were approved by the board of trustees of each system and were enacted into law by the State legislature in the 1977 legislative session.

Senator CURTIS. Could you supply those assumptions for the record?

Mr. SCHWARTZ. Certainly. I could make a copy of the report right here available to the committee.*

Senator CURTIS. Thank you.

That is all, Mr. Chairman.

Senator BENTSEN. Let me state that I think there has been a change in what happened in 1975. Public Law 94–236, which exempts the city pension fund from certain IRS requirements, prohibits any amendment to the 1975 pension agreement which would extend the expiration date of the agreement beyond December 31, 1978.

And then the Ways and Means Committee report on this bill states, on page 9, "An amendment of the agreement which imposes further obligations on the plans or trusts after December 31, 1978, would have

*The report was made a part of the official committee files.

the effect of extending the expiration date of the agreement and would not be considered a part of the agreement for purposes of this bill."

Now, when you had a change in the maturity dates, I think you brought that about and I believe that is a violation of it and it gives me some concern.

Now, let me also comment concerning Mr. Brigham's statement of yesterday. He stated that the city now has an actual budget deficit of about $1 billion, according to generally accepted accounting procedures. He also pledged that the budget would be in balance by 1982.

But then he added the rest of it to that statement. He said in order for New York City's budget to be balanced for the next 4 years, State and Federal aid to that city must be increased by $500 million. Well, that is a contingency that says that the State and the Federal Government are going to have to increase their assistance by $500 million.

Now, in spite of the great expertise and influence of the distinguished Senator from New York on my right, and the other Senator from New York, there is no assurance of that. That is talking about something in addition to what the city of New York does in trying to achieve that budget.

I believe that in any continuation of Public Law 94-236 we have to arrive at some language calling for a balanced budget in a reasonable period of time, as was in the 1975 agreement under generally accepted accounting procedures.

Would you comment on that, Mr. Goldin?

Mr. GOLDIN. Yes; I would appreciate the opportunity, Senator Bentsen. I would point out to you that in 1975 the city's budget was out of balance on a current basis, using generally accepted accounting principles, less than $2 billion. Over the course of 3 years, about $1 billion of that deficit has been eliminated.

I would hope that it would hardly be surprising that, given the essential services that are administered by the city, that it would not have been considered in 1975 practicable for the full extent of reform necessary to achieve a balance as defined by generally accepted municipal accounting principles to be achieved over 36 months. And it is for that reason that the contemplation among all of the relevant parties, city, State, Federal Government, financiers and bankers, was that there would be the reform which has now been achieved to the extent then mandated.

Indeed, I think the Senators and the committee would be interested to know that New York City is now one of the few municipalities in the country in which it is provided by law that there is independent certification of its financial statements on an annual basis. And, indeed, I am pleased to be able to advise you that in December, Peat, Marwick, Mitchell & Co. advised the city that it knew of no reason that it would be unable to certify unqualifiably the city's financial statements this year.

The city's new plan, which has been submitted to the Treasury and to the Congress and to others, envisions the completion of reforms made necessary by accumulated, discredited practices over a period of years within a last 4-year period. At the conclusion of that 4-year period, the remaining budgetary imbalance, as defined by generally accepted municipal accounting principles, will have been eliminated.

Now, that provides a very brief overview of where the city came from, where it is today, and where it is prepared to commit itself by convenant to go under the new plan that it submitted.

Senator BENTSEN. Mr. Goldin, I do not think it was sold to the Congress that way. And perhaps we did not have as much study as we should have had—in fact, I am convinced we did not in the Senate, and that is one of the reasons for these hearings.

Now, I am also told that the city of New York is behind in its contributions to some of these plans. Is that information correct, or not, and, if so, how did it come about?

Mr. GOLDIN. Let me address both points.

Respecting the information that was available to the Congress, I would respectfully urge that all data that was relevant and that was requested and, indeed, beyond what was requested, was made available to the administration and to the Congress in 1975.

I think it important, however, to understand today that all of the parties, the administration, the Congress, the city, the State, the commercial banks, the unions, the pension systems, the sinking funds, independent advisors and analysts all made a mistake in 1975 and that mistake is easy to understand today.

It was the assumption that if the reforms that were mandated in connection with the action of the Congress in providing seasonal loans were to be achieved to the extent required over 3 years that, although that would not constitute, it was understood, total and complete reform, it would represent progress sufficient and far reaching enough to reassure creditors and thereby to cause the reopening of the public credit markets.

Last November of 1977 we learned empirically that that assumption was incorrect, that creditors will not be satisfied in extending public credit with massive reform, no matter how far-reaching, that they are going to insist on completion of reform.

That is the reason that the new plan submitted by the city on January 20th contemplates that over a period of 4 years the finances of the city of New York will have been totally reformed and that all of the yet unresolved credit issues, which it was understood by all parties in 1975 would have been partially resolved at this point, must be totally resolved on an integrated basis before credit markets will reopen.

Now to the Senator's second question respecting underfunding. As the result of the Shinn Commission report——

Senator BENTSEN. Now, I understand there is underfunding and I understand the steps being taken to correct that and I further understand that that is not an extraordinary situation across the United States. But I am asking if you are behind in your pension contribution.

Are you delinquent in the contributions as they were anticipated?

Mr. GOLDIN. No, sir. As a function of State law, a lag is provided for the payment of contributions by the city providing a period of time in which updated data respecting the necessary level of contributions can be computed. The city is current on its contributions, it is not delinquent, but the lag that I have just described is provided in State law and perhaps Mr. Bigel will speak to that further?

Senator BENTSEN. Is the lag being taken advantage of?

Mr. GOLDIN. No, sir.

Mr. BIGEL. Senator, I think we are mixing up something, Mr. Comptroller.

The pension contributions by the city are absolutely current. As a matter of fact, if they were delinquent, it would be a violation of the credit agreement of November 26, 1975. I do think I know where the Senator may have derived that notion.

Senator BENTSEN. I derived the notion from Secretary Blumenthal's statement. That is why I am asking.

Mr. BIGEL. No; it is wrong.

The contributions have always been current, however, the special deputy comptroller for the State of New York yesterday indicated that, by delaying pension contributions, the city could possibly meet its short-term borrowing needs.

The only problem with that is that he represents the comptroller of the State of New York which refused to participate in any way whatsoever in keeping the city solvent. That particular recommendation was knocked down on January 11, 1978 in a meeting with the mayor and there is no such possibility in the budget and pension contributions are current and will remain current.

Senator BENTSEN. But let me state——

Mr. BIGEL. The 2-year lag has nothing to do with this. Contributions are estimated on the payroll of 2 years back, but that has nothing to do with the current status of pension contributions. That 2-year lag is a practice that began in 1921. It is a factor in every single pension system throughout the State, and it really does not figure here.

Senator BENTSEN. There is a 2-year lag, now. Let's be sure we understand what that 2-year lag is, because Secretary Blumenthal in his testimony was talking about an accrued pension liability of 2 years that had not been met. And I can understand we can have problems in what an accrued pension liability is, so I want to understand exactly whether this is a deviation from the funding that would normally have been anticipated.

Mr. SCHWARTZ. Senator, no way. Senator, what it simply signifies is this. Right now, I am in the process of certifying the city's contributions to its various retirement systems to be paid in fiscal year 1979. Since I am presently in the middle of fiscal year 1978, the last complete fiscal year with respect to which I have data of necessity is fiscal year 1977.

Consequently, the contribution to be made in fiscal year 1979 is based on the data as of fiscal year 1977. That is all the 2-year lag signifies.

Senator BENTSEN. All right.

Senator MOYNIHAN. Mr. Chairman, I would like to return to this question that Mr. Schotland has raised about the acute conflict of interest. In my judgment, the Committee on Finance cannot hear this proposition made without exploring it.

Professor Schotland, speak to that point. We have a panel here. This is why we asked you all together, and I hope you would feel free to comment on one another's remarks.

Mr. SCHOTLAND. Senator, I guess it is presumptuous of me to point it out to this committee with you as a member, but the easiest stick to beat on an academic is that he is an academic. There is some value,

perhaps, in academe that now and then and academic might raise a question that others might not raise, like where are the Emperor's clothes, or in this hearing, where are the pension fund safeguards?

I think it would be very illuminating, not only to talk about the conflict, but to talk about why should not New York State give the primary guarantee? I have great respect for Governor Carey but I do not know that, as far as I can see, the mere fact that he happens to be running this year means that Federal taxpayers should be the primary guarantor instead of the secondary guarantor.

Why should there not be, at most, a 10-year deadline on the maturities? Why should there not be a commitment to shrinking amounts of principle? Why should there not be some reasonable number of retiree representatives?

I think these are four pressing questions.

Mr. BIGEL. May I comment?

Senator MOYNIHAN. Please.

Mr. BIGEL. On a conflict of interest question, it is kind of incongruous that the professor singles out solely the New York City retirement systems. The fact is that, throughout the length and breadth of this land, wherever you do have pension plans, and that is in many, many places—there are thousands upon thousands of plans, they are jointly trusteed with an equal number of union trustees and an equal number of management trustees, or, in some plans, they are unilaterally trusteed solely by management, and I just think, Senator, that if we are going to extend this, in law and in logic, then you are going to have to legislate for all of the trustee structures in every single plan in these United States.

Senator MOYNIHAN. Well, we do that sort of thing all the time.

Mr. BIGEL. But I think the professor ought to be consistent. Is that what he is recommending?

Mr. SCHOTLAND. Yes; indeed it is, Senator. I am chairman of a committee on conflict of interests which is bringing out a series of studies on conflict of interest in finance under the aegis of the 20th Century Fund, a foundation in New York City and, indeed, a good friend of New York City and we will, I believe—although it is not final—be recommending precisely that.

I think the difference, the reason why it might be pertinent to consider this matter here, is that we are here talking about New York City, first.

Second, take, as an analogy, fingerprinting. We do not fingerprint everybody in the United States. Some people would like to, but fortunately we do not do that yet.

We fingerprint either people who have some special kind of problem or some sort of status.

We have a special problem in conflict of interest in the New York City—and, it may come to pass, the New York State pension funds, and that is why we have a more acute, in my opinion, I fear, potential abuse of the conflict there and therefore need more safeguards.

Mr. BIGEL. He has not established that, he has just alleged it. Now he has alleged it twice, so it becomes a policy and a principle. He has not indicated where the actual conflict of interests has taken place.

Nowhere in this proceeding, certainly, have I heard any show of

proof that any action taken by the joint trustees, both management and labor, have constituted a conflict of interests.

With respect to the retiree question, Senator, I think it is really a matter of the law of physics, who is going to be stronger in representing the interest of pensioners, a series of diffused people or the unions. And here he and I might have a difference of opinion, but a conflict has not been established.

Senator MOYNIHAN. I think the comptroller asked to speak.

Mr. GOLDIN. Yes, Senator and Mr. Chairman, I would like to speak very briefly to the four points raised by Mr. Schotland.

He states that there is a special status or a special conflict or potential for conflict in New York City and ultimately, perhaps, in New York State. I would point out to him that that derives from the fact of investment in New York City and New York State related securities.

I went to lengths in my prepared remarks to note that those investments were not the idea of New York City or New York State and did not originate with the trustees of the retirement systems. They indeed were imposed upon the trustees in the retirement system, labor and management as a precondition to the preservation of the solvency of the city and because of the inevitable interrelationships between the retirement systems and the city, having to do with funding and payouts and related matters, to the solvency of the retirement systems themselves.

And so, to pursue the tautology that the conflict of interests exists because the investment has been made and that future investments might be made because the trustees have a conflict of interests is to ignore the fact that the potential conflict is, or could be, made to occur because of the superimposition of the requirement by external forces and the acknowledgment of the trustees that it would have not been their preferred route.

Second, Professor Schotland raises a point respecting the State guarantee and was critical of Governor Carey and ascribed the plan to his running for reelection. I think that is unfair and inaccurate.

In point of fact, the plan of the city and the State contemplates that there would be coguarantees and that, indeed, the up-front guarantee would be that of the city or the State, rather, and not of the Federal Government.

Also I would not want to take the time of this committee, unless you wish me to do so, to describe the precariousness of the financial condition of the State of New York as of 1975, the painstaking steps to reestablish that financial position, and the clear adverse impact that a guarantee of $2 billion-plus of New York City securities would unquestionably have on the State of New York.

Therefore, the proposal of the Governor is not politically motivated or connected but represents a prudent and careful assessment of what is in the best interests, not only of New York City and New York State and for him to have proposed further guarantees by the State would have been irresponsible.

Third, Professor Schotland emphasizes the importance of 10-year maturities. Let me point out that one of the not-insignificant elements that contributed materially to the adverse budget situation of the city, which was, in turn, a major factor in its near financial collapse was

the historic practice of relatively short maturities in connection with the sale of long-term debt and all knowledgeable, independent arbiters have subsequently been critical of the city for having sold obligations with relatively short maturities, thereby bunching up interest and principal payments that should have been spread out over a period of years.

In the interests of the viability of the city and in the interests of the financial security of the pension funds as investors in city or city-related obligations, to recommend short maturities is to urge that the city re-resort to a discredited and dangerous practice which would call into serious question the financial viability of the city itself and the solvency of the pension systems.

Fourth and last, respecting Professor Schotland's major point, which is a requirement that there be mandated a period of time in which, on a phased basis, city or city-related securities would have to be sold, represents an abstraction that is almost laughable.

Obviously, if a market is recreated for city securities the pension systems would find it advantageous to sell those securities, because, in all likelihood, given the enormous coupon which attaches to those securities, in the event of a reestablishment of a public market, those securities could be resold at a premium and a handsome profit.

In the event that the market were not to be created publicly for city securities, to require that they be sold is to require that huge losses be taken purposelessly, because now, as you were told by Mr. Schwartz, with the city paying principal and interest on those obligations on a current basis, the actual return to the retirement systems is handsome, indeed, and compares favorably, no doubt, with any other funds similarly situated throughout the United States.

And so, while I am respectful of Professor Schotland's suggestions, on close examination I respectfully urge upon this subcommittee that none of them can withstand scrutiny.

Senator MOYNIHAN. My time has expired. I would like to say that Mr. Schotland was asked as to specific allegations with respect to conflict of interest, and perhaps if he would wish to do so in writing to this committee, I know that I would very much like to see them.

I do not want to cut you off—and perhaps you would let me make one statement, Mr. Chairman, and give Professor Schotland a chance to respond. I would like to refer to the comptroller's statement about the enormous coupon.

Is there a regional coupon?

Mr. GOLDIN. I think it depends on whether you come from the west side or not, Senator.

Senator MOYNIHAN. If ever there is a commentary upon the kind of ultimate incompetence of the government of New York City it is that we finally went bust. And who really made money out of all those good years, those go-go years? The rich, I mean literally, filthy rich. I mean we had to raise our interest rates and give tax-free money such that anybody who was rich in New York is twice as rich now as a result of my city's squandering its resources. The amount of tax-free money—we sold tax-free bonds at 10 percent and 11 percent is staggering.

There must be a law against that and if there is not, there ought to be. I mean, the filthy rich have really enjoyed all the benefits in this area of bonds.

It is not the fault of those rich people that they are getting richer, they can do it. They were against all the policies that led to bankruptcy. However, this is the final irony—the only people who benefited are the people opposed to all of it.

Mr. Schotland, you wanted to say something?

Mr. SCHOTLAND. Thank you, Senator. Thank you, Mr. Chairman.

I do not know why Mr. Bigel and the comptroller are beating on me. When I appear before this committee, as I have several times, on issues involving the giant New York City banks, I know why they are beating on me. But I do not know what it is that I am saying today that is in some way so far off. Let me point out the polar thinking the comptroller has slid into. The question is not whether or not the funds ought to invest——

Senator BENTSEN. I think next time we will try to see that you are not outnumbered three to one, Mr. Schotland.

Mr. SCHOTLAND. Thank you. Thank you, Mr. Chairman.

The question is not investments or not. I am for the investments. I do not see how anybody realistically can be against them.

The question is, what safeguards? The question is not long maturities or short maturities. The question is, how long?

It was not 10-year securities that got New York City into trouble. We know what got New York City into trouble, it is these very short-term notes.

May I read from the Ways and Means Committee report—there was none from the Finance Committee because this was done by the Senate, and I think rightly, with such speed that the Finance Committee never got this bill, and this is the first time this matter has been looked at; therefore, it is doubly important.

The Ways and Means Committee said, "the notes acquired by the plans through exchanges and so forth, are to mature not later than July 1, 1986." They now have half a billion down to 1995 and they have got around a billion beyond 1986.

I think some safeguards are called for. I think 17-year maturities are abusive.

As to the lack of conflict of interest, what on earth was Public Law 94-236 passed for? Why on earth was New York State law passed exonerating the trustees? Because of my baseless allegations? Surely not. It is because there is a real problem there.

Mr. BIGEL. I would like to assure Professor Schotland that I, of course, have the greatest respect that I can muster upon this very short acquaintance and I am sure that that respect and admiration will grow upon maturity.

I have one——

Senator MOYNIHAN. By 1986?

Mr. BIGEL. No; by 1996.

I have just one basic problem with Professor Schotland, because I know we are going to leave here as friends and colleagues, and that is that he has not really secured all the facts.

For instance, let me go back to the transaction of August 1977, to which he has made some reference. I think that Professor Schotland could have questioned some of us privately before this hearing about that transaction. He could have contacted the Municipal Assistance Corporation, or our distinguished comptroller who is always available to everybody in the city of New York, Mr. Schwartz, or myself.

I would like to tell you about that transaction.

It all stemmed out of that court of appeals decision and so—I would like to describe it, but I think the professor makes these broad, sweeping generalization without any show of proof.

Now, we had $983 million in notes to individuals and about $1.1 billion and the court of appeals said to us, pay it off, and pay it off like that. Now, frankly, Senator Moynihan, we did not have time to consult with Professor Schotland, and so I will tell you what you did.

We raised that $983 million really by scraping the barrel and the court of appeals said that is fine, and they were paid off. And nobody anticipated the $983 million, when we talk about that $2 billion deficit, Jay, and then we had the $1.2 billion or the $1.1 billion, and we had some money in that, about $300 million.

I raised the question at that time, Mr. Chairman, is this not a new transaction? And Treasury finally advised us that this was really covered under the credit agreement of November 26, 1975.

Now, what did we do then? We were frozen at a 6-percent rate of interest by the moratorium passed by the State legislature. We turned that in for 7¼-percent coupons—rate of interest, Senator Moynihan—and we had to extend that.

But I have to tell you, Mr. Chairman, I am the strongest advocate of the shortest term paper that I can negotiate and a problem that I have constantly had with Mr. Goldin is that he does not let me get away with it. I even tried to negotiate a 3-year bond last year and he would not let me do it because of the impact on the budget.

The fact is—I know he is right fiscally, the longer the life of the bond, the easier the impact on the budget, and I think Professor Schotland has to rub his nose in the dirt of those marketplace transactions as I have.

I would be very happy to share all of the material that I have. He has made some statements about the MAC offer that is not true, and I brought—it is not factual—and I brought copies of that for the record. But we would be very happy to work with Professor Schotland in advance of hearings. It is not our intention to make headlines; it is our intention to make progress.

Senator BENTSEN. Let me say, Professor Schotland, I will not have to wait until 1996 to have respect for you. You have done a distinguished job before this committee and you are a distinguished professor at Georgetown University and well-versed in pension matters.

We appreciate your testimony and so far as anyone having all the solutions or being right on all of the facts, and being able to project them in the future, we have just been advised by Mr. Goldin that the testimony given before in 1975 turned out to be wrong, the assumptions turned out to be wrong.

So it is well that we have these diverse views as we try to weigh what to do, a possible extension of this piece of legislation.

Now, we have another witness and the Senate will be convening at 12 p.m. (noon) and unless the Senator from New York has further comments——

Senator MOYNIHAN. I would like to thank you, Mr. Chairman, and I would like to thank the panel.

Senator BENTSEN. Thank you. Thank you very much, gentlemen.

[The prepared statements of the preceding panel follow:]

STATEMENT OF ROY A. SCHOTLAND, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY

Despite the complexity of this financial problem, the facts proving four key points are simple and clear. They show the need for four easily implemented safeguards in any bill extending P.L. 94-236.

Point One. The Members of this Committee have an unusual, perhaps unique, obligation here. It isn't often that protecting the purposes of provisions giving special tax treatment, rises to the level of moral duty. But the Internal Revenue Code's pension provisions exist because Congress decided to help assure retirement security. Congress included numerous safeguards, lest retirement security be the facade behind which less worthy purposes were pursued. Central among the safeguards are the provisions from which, in 1976, New York City's five pension funds were temporarily exempted.

The true question before this Committee is not whether that exemption shall continue at all, because some continuation seems unavoidable. The true question is whether the Committee will go along with the weakening of protections which were present when the exemption was first granted, but which in August 1977 were removed with our Secretary of the Treasury—and I speak as a supporter of this Administration—going along.

I will below specify the kinds of protective safeguards which must be attached to any extension of the Public Law 94-236 exemption.

If the old people are to be protected, no one will do it if this Committee does not. The Treasury Department and Senate Banking Committee seem to see this problem of municipal bankruptcy as an occasion for moral bankruptcy. They say, don't involve the federal taxpayer, let the New York pension funds carry the load. Their position is certain to reduce the retirement security of those funds' beneficiaries; and it's likely to merely delay rather than avoid the hard truth that if New York City cannot be brought around, the Federal taxpayer is bound to have to pick up the pieces. Congress' Human Resources Committees, who share with you the concern for retirement security, are not participants in the New York City aid legislation.

Who will stand up for the thousands of old people whose retirement security depends on those funds' solvency?

Point Two. This Committee's *moral* obligation is acute because no one else is protecting the pension fund beneficiaries. The trustees of the funds include no representative of retired persons, only representatives of the City and of current employees. The policemen's fund has four separate representatives for the Patrolmen's Benevolent Association, plus one for the captains, another for the lieutenants, still another for the sergeants and yet another for the detectives. I am not joking, this is the composition of the fund's board. The firemen's fund is similarly constituted. But there is no room for even one voice for the retirees in any of these funds!

The five City funds' trustees have consistently succumbed to a severe conflict of interest. They have not acted as trustees but instead, and here I quote Jack Bigel (in an Op-Ed article he wrote in the New York Times one year ago, Feb. 2, 1977), they have acted as "the leaders of the municipal unions, in their capacity as trustees of the city's five retirement systems." "Everything is related to everything else," as he is saying in current negotiations. (New York Times, March 4, 1978, pp. 1, 9). Union leaders and trustees chosen by only current employees have differing, even conflicting, interests as compared to the unrepresented retirees.

For the union leaders and current employees who do control the funds, current wage boosts matter as much or more than the pension funds' solvency. I request the Chair's permission to insert into the record of this Hearing the excellent front-page background article on the key role of the pension funds, and the conflict of interest of their trustees, from the New York Times of Saturday, March 4.

Can anyone question that if retiree representatives were on the fund boards, even though they would inevitably be only a minority, the retirees' interests would have been more forcefully advocated, and the funds would have secured fuller safeguards?

The trustees have been protected from liability for dropping their fiduciary obligation, so they are free to use their trusteeships to advance the union leadership's positions as individuals and the union's position in wage negotiations with the City. I believe the funds can continue to aid the City's fiscal crisis without being supine. But only this Committee and the Ways and Means Committee can assure safeguards against the insolvency supineness will bring.

Point Three. The trustees, having put their fiduciary obligations beneath their union's interests, have joined the rest of New York officialdom in gimmicking

down the solvency of the pension funds just as earlier the solvency of the City itself was gimmicked down. Even after the 1975–6 crisis and bailout by the pension funds, the funds have been weakened in three critical ways. There has been no public attention for these gimmicks, and the Treasury Secretary and Senate Banking Committee act as if there had been no gimmickry. After the enormous role of hidden gimmicks in destroying New York City's fiscal soundness, that such key people in Washington now go for gimmicks shows that the Law of the Austro-Hungarian Generals is still followed: Carry on with the tactics of the last war, we can only lose another one.

In the opening paragraph of Public Law 94–236 enacting the three-year exemption, Congress referred to the November 1975 agreement between the funds, the City, MAC, and the banks. That agreement committed the pension funds to buying about $2.5 billion of New York City and MAC debt, the sum which was needed by the City but which no other sources would buy. That sum happened to represent about 35 percent of the pension funds' assets. Three important safeguards for the funds were explicit in the 1975 agreement on which Congress explicitly relied in passing the exemption from the Tax Code's safeguards. Each of these safeguards was deleted—and no substitutes were put into their place—last summer.

The 1975 Agreement's safeguards: (1) "At the time of any exchange, renewal or purchase of City notes, the Mayor, Comptroller and State Emergency Financial Control Board would certify that the City's budget is balanced." This protected the funds from being kept on a sinking ship as it went down. Since the August 1977 revision, accepted by the Treasury Secretary, this provision is simply dropped. (2) Upon renewal or exchange of City notes, the new notes would "be in a principal amount which shall be reduced annually." This protected the funds from remaining so fully exposed. This provision is also missing since last summer's revision. (3) "The final maturity date" of any City note to be held by the funds "shall not be later than July 1, 1986." In a similar vein, the latest maturity date for MAC bonds was February 1, 1986. The shorter-term a security, the less the risk and the greater its marketability.

The Ways and Means Committee Report on Public Law 94–236 expressly noted that "the amount of City notes the plans are required to hold . . . is gradually reduced and phases out on July 1, 1986." In fact, instead of the holdings being reduced, by June 30, 1978 the funds are bound to have $3,543.3 million in City and MAC securities. And just as the amount of holdings has risen instead of falling, the maturities have been lengthened. Although the Ways and Means Committee relied on the 1986 deadline for City notes, the funds already hold $148.7 million of such debt which does not come due until 1988–1991. In addition, $271.5 million or 30 percent of the funds' MAC debt comes due in 1992, and another $561 million or 64 percent comes due in 1995. In stunning contrast, the latest maturity of the $2.5 billion of City debt which the funds had to take under the November 1975 agreement, was November 1976! So much for the maturity date protection Congress envisioned in passing Public Law 94–236.

Lengthening the maturities is a gimmick the public has not been told about, more flim-flam worthy of the people who brought New York City to fiscal crisis. To cap it off, the Senate Banking Committee and Treasury Secretary not only ignore the loss of the 1975–6 commitments to reduce the funds' risk, but have turned things around by inventing an alleged commitment by the funds to hold indefinitely at least 35 percent of fund assets in City and MAC debt, increasing by $1.3 billion by 1982 these risky holdings, as the funds grow—unless they collapse, as the firemen's fund may this year.

Already, the funds have suffered substantial losses and the beneficiaries' retirement security has been worsened. I request the Chair's permission to insert into the record of this Hearing a recent New York Times letter from the President of the New York Teachers Pension Association, William Withers (New York Times, March 4, 1978).

If vested pension benefits are "too rich," i.e. more favorable than are now deemed appropriate, then if reduction is lawful at all it must be carried out lawfully, not by subterfuge. And above all, in no event can the reduction go to zero or below clearly appropriate levels, as is occurring by gimmicking the funds toward insolvency.

Last, Point Four. The incumbent Treasury Secretary has not only permitted the pension funds protections to be seriously weakened although he had the responsibility to preserve at least the protections Congress expressly relied upon in aiding New York in 1975–6. Worse, the Secretary is now pressing New York officialdom to undermine their pension fund solvency even more than they believe appropriate.

Last summer the Secretary defended allowing the funds to be burdened with longer-term debt on the ground that the new debt would bear higher interest rates and be more marketable, and so the funds would be able to reduce their holdings of city and MAC debt. Now he proposes to burden the funds with increased debt as well.

The Secretary now seeks a blank check from Congress to write Federal guarantees. The proposal is still very fuzzy but apparently gives little protection to either the Federal taxpayer or the New York City pension beneficiary. The Federal guarantee seems wise because so necessary. But the Federal taxpayer need not and therefore should not be the primary guarantor: Surely the primary guarantor, for at least about half the securities guaranteed, should be New York State. Making New York State the primary guarantor will help greatly to energize local pressures for fiscal rebuilding. And if the Federal taxpayer were in the proper role as only ultimate guarantor, then the pension funds could secure what they must have: Ultimate Federal guarantees for all the risky local debt they hold and throughout the period it is held. Felix Rohatyn says "Surely fiscal prudence does not limit ones investments to 100 percent federally guaranteed bonds. (New York Times, § 4, p. 19, March 5, 1978.) But if the bonds are so risky that they are being dumped into the pension funds to whatever extent no one else will buy, then surely fiscal prudence demands for such investments nothing less than 100 percent ultimate Federal guarantees.

In offering the funds the lesser guarantees than prudence and fiduciary obligation require, the Secretary reportedly is showing less concern for the funds' solvency than are Mayor Koch and local officialdom. (New York Times, Feb. 28, 1978.) Thus the old people dependent on these funds, increasingly victimized by the conflict of interest of their trustees and New York City officials, instead of getting help from the more neutral Federal Treasury, find only another set of officials trying to push as much of the problem as possible onto the old people.

In conclusion: What should be done?

1. Extend Public Law 94-236, but experience shows the wisdom of limiting that exemption from Internal Revenue Code safeguards to maximum of three years.

2. Restore the protective provisions of the November 1975 agreement Congress relied upon in passing Public Law 94-236, but this time put the protections into the legislation itself lest the 1977 wipe-out be repeated: (a) Assure, with appropriate dates, a balanced city budget certified by the EFCB. (b) Assure commitment to steadily reducing the funds' holdings of city and MAC debt. If the city cannot gradually restore its own solvency, then the funds as well as the city will go bankrupt. The pension funds can be a temporary crutch for the city, but the longer the crutch is leaned on the more certain it will break. (c) For the same reasons, assure a commitment to a limited maturity. Since 1986 was the farthest maturity date envisioned when Public Law 94-236 was passed in 1976, and since the Treasury Secretary has already allowed $981.2 million to be dumped on the funds, with later maturity dates—$561 million down to 1995—I submit the new legislation should repeat the 10-year limit, i.e. 1988, excepting only the unduly risky securities already improperly in place.

3. All state or local debt (including MAC or other agencies) imposed on the pension funds hereafter should be (a) primarily guaranteed by New York State at least to a substantial extent, e.g. 50 percent; and (b) all such securities to be guaranteed by the Federal Government secondarily, or primarily; only to a limited extent. Both guarantees to operate only in favor of the pension funds, and as long as such funds hold such securities.

4. In the effort to reduce gimmickry by making the players more accountable: (a) Restore the 1975 practice of publishing in the Congressional Record any amendments to the agreement of November 1975 (see Cong. Rec. pp. S21808-10, Nov. 26, 1975). Include the securities' maturity profile. (b) Require similar publication upon any change in the maturities, rates of interst, or other material terms of state or local debt held by the pension funds. (c) Instead of waiting to have the Treasury Secretary notify the chairmen of this Committee and the Ways and Means Committee of any amendments he is allowing in the pension funds' agreement, the Committee should receive the proposed agreement as soon as the Secretary does.

One last recommendation of enormous importance although perhaps not for enactment. Since the Federal taxpayer is "in," and risks being "in" much more, Federal representatives should insist that the city funds and the State raise the

likelihood that the pension funds will stay solvent. One easy, crucial step: reasonable representation of retirees must be included on every pension fund board involved in trying to rescue New York City.

[New York Times, March 4, 1978]

CITY FISCAL REPAIRS PENSIONERS' BURDEN

To the Editor:

The use of the pension funds to solve the financial problems of New York City results in certain side effects which may be as unexpected and pernicious as those of certain "wonder" drugs.

For example, by June 30, 1976, the Teachers' Retirement System had lost 158 million through the sale of non-city bonds to buy approximately $567 million of city and M.A.C. securities. In other words, the teachers' pension fund was losing 28 cents on the average on every non-city security it sold and had to sell $1.42 of its assets for every dollar it gave to the city. By June 30, 1976, none of these losses had even been amortized.

Another side effect is an intolerable burden loaded upon recent retirees individually. In 1975, a person retiring from the city colleges or the school systems had to wait about three months to receive his or her first pension check. In the meantime, the new retirees could at least obtain estimates of the amounts they would eventually receive. Now retirees are having to wait nine months for their first pension checks, and they are not even able to obtain estimates of how much they will receive.

This delay is causing some retirees acute financial difficulties. The reason usually given for it is the reduction in the staff of the retirement system. It is paid by the city, and has suffered reductions along with other types of city staff. But failure to pay a retiree his pension for nine months, and without any interest for the period of delay, obviously eases the financial burden of the city at the expense of prospective pensioners, who can ill afford to bear this.

WILLIAM WITHERS, *President,*
New York Teachers Pension Association, Inc.

[New York Times, p. 1, March 4, 1978]

THE BLUMENTHAL LOAN PLAN: FIRM AND AMBIGUOUS

(By Steven R. Weisman)

ALBANY, March 3—In producing his plan to help New York City, Treasury Secretary W. Michael Blumenthal has accepted the basic concept of what the city wanted by calling for Federal guarantees for long-term—as opposed to short term, or "seasonal," loans. But he has raised the possibility of imposing conditions that the city and its partners—particularly the public employee pension systems—might find difficulty to meet.

What the Secretary did most of all in his testimony yesterday before a subcommittee of the House Banking Committee was to leave deliberate ambiguities.

"He fuzzed it up," said one official close to the fiscal negotiations.

Thus the greatest significance of the Blumenthal presentation is that it gives an intentionally wide berth to the negotiations that must now ensue between the city and its allies—the banks, the municipal labor unions—on the one hand, and Congressional opponents of Federal aid on the other.

"I'm reminded of 1975, when we used to achieve our 'monthly miracles' rescuing the city from default, and we all sat around beathing easily for about 24 hours before we had to start all over again," said Felix G. Rohatyn, chairman of the Municipal Assistance Corporation, who is now, as he was then, the primary architect of the financing plans.

"With the Blumenthal proposal, we've come a long way, but it's really only the beginning," Mr. Rohatyn said.

According to a source close to the negotiations with Mr. Blumenthal over the last few weeks, the Treasury Department had originally favored a tougher, more explicit proposal for New York City and has sent it to the White House for final approval. The White House, having a different sense of strategy, was said to have persuaded the Treasury Department to make the proposal more vague.

The key aspect left unclear in Mr. Blumenthal's plan is the role of the municipal employee pension funds. Mr. Blumenthal testified yesterday that the pension

funds would probably be the purchasers of the $2 billion in federally guaranteed bonds—essentially the position supported by Mr. Rohatyn and the city.

Secretary Blumenthal is fully aware, however, that Senator William Proxmire, the Wisconsin Democrat who opposes Federal aid to the city, thinks the pension funds should take the $2 billion in bonds without Federal guarantees. This the pension funds have said they would refuse to do.

Evidently as a concession to Mr. Proxmire, Mr. Blumenthal hinted, but never said explicitly, that he expected the pension funds to accept some bonds in the years ahead "on an unguaranteed basis," the most pointed instance of his intentional ambiguity.

Probably no question is more critical to the upcoming negotiations than what sort of bond, or mixture of bonds, the pension systems would purchase. To understand why, it is essential to remember that the pension funds are in effect controlled by the municipal labor leaders.

THE INFLUENCE OF WAGE TALKS

Although the decisions on pension lending are officially governed by "fiduciary" considerations, they are thus inevitably influenced by what the unions want in their upcoming wage negotiations with Mayor Koch.

In meeting after meeting with fiscal officials, Jack Bigel, the labor unions, consultant and key strategist, has a favorite negotiating position. "Everything is related to everything else," he says—an oracular remark city officials take to mean that if the pension funds are pressed to accept large parts of unguaranteed bonds, they could reasonably demand a more generous wage settlement in return.

"Sometimes when I hear Jack say he he can't buy any more bonds, I hear a little bit of, 'Please, please, don't throw me into the briar patch,'" said a state official who has negotiated with Mr. Bigel. According to this view, Mr. Bigel and the pension funds know that they will inevitably have to buy some unguaranteed bonds, if only to placate Senator Proxmire to get a final agreement on a city rescue package, and that they might as well make the most of this necessity in advance.

For the same reason, Mayor Koch has strongly pressed Secretary Blumenthal not to require that the pension funds buy unguaranteed bonds. He understands that the pressure to meet such a requirement by granting wage increases would be huge, and unbearibly so for a man whose election victory echoed with promises of toughness at the bargaining table.

In formulating his proposal, Mr. Blumenthal was thus caught between the New Yorkers and Mr. Proxmire. He solved the problem by leaving his options open and hoping that a future negotiated settlement with the unions, the burden of which would be on the city, would ease the way toward a solution.

"Treasury knows that Proxmire is not moving one inch until the labor negotiations are over," said a senior city official. "To firm up his proposal now serves no useful purpose. Blumenthal is hoping we can get the unions to show some restraint and cooperation. The we go back to Proxmire, so he can say, 'Ah, here is something new that you didn't tell me before,' and maybe change his position."

WHY THE $2 BILLION FIGURE

Of the city's $5 billion in long-term borrowing needs in the next four years, Mr. Rohatyn and Mr. Koch have projected that all but $2 billion can be raised from public bond offerings, or from the major commercial banks. This is why the current debate has focused on the $2 billion, and on whether it should be purchased by the pension funds with or without guarantees.

There is certainly no question that the pension funds could buy nonguaranteed securities if they wanted, as Mr. Proxmire demands. Simply to maintain their holdings of city and M.A.C. bonds at their current 35 percent level in the next four years, as the Wisconsin Senator has pointed out, the funds would have to buy more than the $2 billion for which guarantees are being sought.

But there is a serious question whether a fiduciary—a pension-fund trustee—could properly buy such securities in the absence of some sort of Federal participation to minimize the risk involved. This is a point that is made not only by the union leaders, but also by the New York City Comptroller, Harrison J. Goldin. The State Comptroller, Arthur Levitt, makes the same point for the state pension funds.

Just as Mr. Blumenthal's suggests the possibility of pension-fund participation "on an unguaranteed basis," the pension-trustee position raises the possibility of

a mixture of guaranteed and nonguaranteed bonds. That, at any rate, is the hope of the people who will be negotiating with them in the months ahead.

There is one final reason why supporting Federal guarantees for bonds carried by the pension funds is an attractive approach by the city and its supporters. Many members of Congress are worried that securities that are guaranteed by the Federal Government would compete unfairly with other government securities in the marketplace. Selling the guaranteed bonds to the pension funds at least avoids setting what these critics see as a bad precedent. The city's drama moves out of Washington now, right to the labor bargaining table.

Statement of Jack Bigel, Consultant to the Municipal Labor Committee

INTRODUCTION

The Trustees of the New York City retirement systems are again being asked to commit billions of dollars of fund assets to the purchase of and reinvestment in city bonds.

The Trustees of the New York City retirement systems have refused to commit to further investments in New York City bonds but the calls for further financial participation have not abated.

The Mayor of New York City, Mr. Koch, initially called for the pension funds to purchase $900 millions in new investments and the roll-over of maturing securities.

The Mayor also called for delays in city contributions to the pension funds, which constitutes short-term loans to the city, but later wiwthdrew the proposal.

The Senate Banking Committee has called on the pension funds to invest $1,300 millions in new city bonds and to roll-over maturing securities.

The fact that the pension fund Trustees have already agreed to invest $2,530 millions in city bonds between December, 1975 and June, 1978, it is not contradictory, or inconsistent with, their refusal of further participation in the financing of New York City.

A review of the background leading up to the November, 1975 agreement will demonstrate that the agreement guaranteed the survival of both the city and its retirement systems: without the November, 1975 agreement, each would have collapsed.

Prior to November, 1975, the fiduciary responsibilities of New York City retirement system trustees were explored in depth among themselves and with their attorneys. The classical concept holds that trustees of the retirement system and/or plan must protect the integrity of its assets; moreover, their primary responsibility is to all participants and beneficiaries of the plan.

In evaluating the responsibilities, the trustees were first concerned with the protection of both retired members as well as those members who would retire if New York City were to declare bankruptcy.

As of June 30, 1974, 71,267 New York City retirement system members were eligible to retire. The number of members eligible for retirement are summarized in Table 1.

The concept of fiduciary responsibility was applied in the most literal sense in conjunction with a data base consisting of the assets, liabilities and payment obligations of the five New York City retirement systems.

TABLE 1.—NUMBER OF CITY EMPLOYEES ELIGIBLE FOR RETIREMENT—VALUATION DATE, JUNE 30, 1974

Retirement system	Eligibility requirements for service retirements	Number eligible as of June 30, 1974
(1) Police	20 years of service regardless of age	4,698 (a)
(2) Fire	do	2,671 (b)
(3) Teachers	25 years of service and age 55; or age 55 regardless of service	13,132(20+) (c)
		12,796(55+) (d)
(4) NYCERS:		
CPP–ISF	do	7,948(25+) (e)
		37,729(55+) (f)
Sanitation	20 years of service regardless of age	3,256 (g)
Police (ancillary)	do	778 (h)
Transit	20 years of service and age 50	8,340 (i)
(5) Board of Education	Same requirements as CPP (NYCERS)	1,000 (j)

Note.—Total eligible=(a)+(b)+(d)+(f)+(g)+(h)+(i)+(j) 71,267.

The trustees were faced with two alternatives in November, 1975. They could invest or not invest in city bonds. Illustrated in table 2 are the consequences of not investing: City bankruptcy, no employer contributions in futuro; and only the systems' assets available for investment to meet current and future obligation.

Table 2 was developed taking into account the market rather than the book value of the assets, since assets would have to be liquidated in order to pay current and future benefits. In addition, of the $7.7 billion assets, some $1.5 billion represents the accumulated contributions of the employees themselves. Under law, employees would be able to withdraw about half of that total amount from the retirement systems. In the event of a bankruptcy, it must be assumed that employees will need any and every source of income available to them. This would also include the actual retirement of the 71,000 eligibles shown in table 1.

Table 2.—Impact of Default On The Five Retirement System For The Fiscal Year 1975/1976

	Millions
Assets:	
Book value	$7,725
Market value [1]	5,815
Value net of employee withdrawals	4,565
Income:	
Employee contributions	0
Investment income	250
Total income	250
Disbursements:	
Annual benefit payments including death benefits [2]	980
Net annual deficit	730

[1] Estimated by the Comptrollers Office.
[2] Assuming retirement of all eligibles (See appendix A).

This demonstration shows that the retirement systems would generate an annual deficit of $730 millions. At that rate, the retirement systems would exhaust their entire assets in a matter of about eight years, at the maximum, and all payments to all retirees and beneficiaries would thereafter cease.

The second alternative, shown in table 3, illustrates the impact on the distribution of assets of the retirement systems assuming investment in New York City and/or MAC securities over the next three fiscal years.

The assumptions underlying this exhibit, were as follows:

The yield on the New York City securities would be approximately 9 percent, considerably higher than the systems' overall rate of investment return.

The contribution of over $3.5 billions by the City through 1977/78 would make it possible to purchase these securities with a minimum liquidation of present holdings.

Table 3 shows that the projected experience over the three years of the fiscal crisis.

With employer contributions continuing, employee contributions would also continue and total an estimated $696 million.

Investment income would generate an estimated $1.06 billion over the three year period.

During this period retirement benefits and other payments to members would total $3.665 billions.

The systems would in short, show an increase in assets of $2.3 billion during those three years after meeting all obligations.

Table 3 also shows the ratio of MAC/City bond investments to total assets for each year of the fiscal plan. The change in this ratio would increase from 17.9 percent in 1975/1976 to 32.3 percent in 1977/1978.

The data presented in the foregoing tables were available to trustees, the chief actuary and investment advisors of the various systems by November 24, 1975.

On that date, the boards of trustees met and approved participation in the fiscal package which averted default.

There is no doubt that participation was motivated by the objective of maintaining the solvency and integrity of the systems, thereby enabling the trustees to discharge their obligation to all participants and beneficiaries.

TABLE 3.—PROJECTION OF PURCHASES OF NEW YORK CITY AND MAC SECURITIES

[Dollar amounts in millions]

	Fiscal year 1975–76	Fiscal year 1976–77	Fiscal year 1977–78
Assets, beginning of year	$7,725	$8,348	$9,145
Employer contributions [1]	1,021	1,240	1,365
Employee contributions [2]	232	232	232
Investment income [3]	450	560	650
Total income	1,703	2,032	2,247
Benefit and other payments [4]	1,080	1,235	1,350
Net addition to assets	623	797	897
Assets, end of year	8,348	9,145	10,042
New York City and MAC securities owned at Nov. 30, 1975	967	1,497	2,747
New purchases from net addition to assets (Dec. 1, 1975 to June 30, 1976) and rollover	530	1,047	500
Purchase from sale of assets	0	203	0
Total additions of such securities	530	1,250	500
New York City* and MAC securities owned at end of year	1,497	2,747	3,247
Ratio of total assets invested in New York City and Mac securities (percent)	179.9	30.0	32.3

*Includes URN securities.

Note: see appendix for footnotes.

By virtue of entering into the November, 1975 agreement, the trustees insured that empoyer contributions would continue to flow into their retirement systems. They insured that pension and other benefits would continue to be paid to their members.

In short, the November, 1975 agreement represented an unprecedented exercise in trustee responsibility, because elements of that agreement stand in counterpoint to rigid, and staid interpretation of actuarial practices.

In the judgment of the trustees, it was wholly possible that New York City would still go into default or bankruptcy. However, in the event of a declaration of default or bankruptcy, which would render New York City bonds valueless, the Trustees would have markedly increased the pension fund assets available for the payment of benefits to both active and retired pension fund members.

Assets Available For Benefit Payments [1]

	Millions
November 1975	$4,465
June 1978	6,250
Increase	1,785

[1] Assuming New York City securities have no value.

OTHER REQUESTS FOR PENSION FUND INVESTMENTS

The commitment of $2,530 millions in bond purchases by the pension funds represented the only new financing available to the city between December, 1975 and June, 1978.

The fact that the trustees agreed to the purchase agreement simply led to further demands that the pension funds invest even more pension fund assets in city or M.A.C. bonds.

In November, 1976, the New York State Court of Appeals ruled that a moratorium on the redemption of short-term city securities was unconstitutional. As a consequence of that decision, the city was required to raise $983 million within a three-month period in order to redeem the notes that had been in moratorium.

An immediate call went out to the pension funds to lend the city the $983 millions necessary for the note redemptions.

The pension fund trustees refused the request.

The basis for their refusal lay in the single fact that further investments, if they subsequently became valueless, would diminish the pension fund assets available to pay benefits.

The pension fund trustees did, however, use their offices and abilities to co-operate with the city and M.A.C. in the development of a plan to finance the redemption of moratorium notes and that redemption was successfully made between February and August of 1977.

STATUS OF THE PENSION FUNDS AT JUNE 30, 1978

New York City currently faces a situation, on July, 1978, where it will have neither short-term nor long-term financing available.

The possibility of a New York City bankruptcy is real and the probability of bankruptcy appears to be greater than at any time during the past four years.

In November, 1975, the pension fund trustee were satisfied that their commitment to purchase $2,530 millions in city bonds would provide New York City with the resources to survive to June 30, 1978. Such survival meant that the net assets of the pension funds available for benefit payments would increase.

The correctness of the decision of the pension fund trustees to purchase city bonds is confirmed by the exercise contained in Table 4.

Table 4 shows that, if the city goes into bankruptcy on July 1, 1978, pension fund assets will be sufficient to pay benefits through 1984, or 4 years longer than if the city had gone into bankruptcy in November, 1975.

Furthermore, the pension fund trustees are not satisfied that the further investment of pension fund assets in city bonds is in the best interests of pension fund members.

The city has presented a four-year financial plan that is the basis for developing the financing needs of the city.

TABLE 4.—IMPACT OF DEFAULT IN JULY 1978, ON THE 5 NEW YORK CITY RETIREMENT SYSTEMS

[In millions of dollars]

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
Net market value of assets, beginning	[1] 6,350	5,500	4,610	3,670	2,675	1,625	516
Investment income	350	310	260	205	150	91	29
Total	6,700	5,810	4,870	3,875	2,825	1,716	545
Benefit payments	1,200	1,200	1,200	1,200	1,200	1,200	1,200
Market value of assets, end	5,500	4,610	3,670	2,675	1,625	516	[2] (655)

[1] As estimated by the actuary of the New York City retirement systems.
[2] Deficit.

The pension fund trustees are not satisfied that the city can accurately project all of the negative events that can take place in the course of four years. For example, a decrease of only 5 percent in real estate tax collections represents a $150 million loss of income; or, the termination or contractions of C.E.T.A. programs can have an enormous negative impact on the city's budget.

The pension fund trustees recognized that it was wholly possible that its $2,280 million in city bonds would be worthless on June 30, 1978, but, even with that worthless paper, active and retired pension fund members would be better-protected.

If required to purchase new city bonds on the scale proposed by the Senate Banking Committee, the pension funds would hold $3,580 million of bonds. If $3,580 million in bonds became worthless, the Trustees are not satisfied that pension fund members are best-protected.

The pension fund trustees are not satisfied that the totality of the city's financing needs during the next four years can be adequately met by the current proposals, or that no further demands will be made upon the trustees during the next four years under an imminent threat of default or bankruptcy. Tables 5 and 6 show that no major municipal or state retirement system holds bonds issued either by the sponsoring political entity or by any other municipal or state government. In contrast, 85 percent of New York City pension fund assets are in New York City or related securities.

The New York City retirement systems have been widely criticized as being underfunded.

In fact, the New York City retirement systems are among the more soundly-financed retirement systems in either the public or the private sector.

In 1975, New York City Mayor Abraham Beame appointed a Mayor's Management Advisory Board, chaired by Mr. Richard Shinn, President of the Metropolitan Life Insurance Company. The Board, in August, 1975, appointed a Pension Task Force to examine the New York City pension funds and make recommendations to improve their soundness.

In April 1976, the Board released the report of its Pension Task Force; that report concluded that the funds were actuarially sound, even though long outdated mortality tables were being used by the pension funds.

"A comparison of the estimated liability for retirees based on the present and proposed assumptions indicates that the variation between the two falls within a 10 percent range. This is primarily due to the compensating effect of a conservative interest rate; i.e. 4 percent, and an inconservative mortality table. Despite this offsetting relationship, a revision of the actuarial assumptions is being proposed to reflect the up-to-date experience with respect to both interest rate earned and mortality assumptions."

In analyzing the level of funding, or the depth of funding, the Pension Task Force compared the assets of the following pension funds to their total accrued liabilities (assets on hand compared to all benefits earned by active and retired members to date).

Ratio of Assets To Accrued Liabilities

Plan:	Percent
N.Y.C.—all systems	53
N.Y.S.—all systems	81
U.S. Civil Service	22
General Motors	51
Union Carbide	61
Metropolitan Life	100
Consolidated Edison	24

Clearly, the New York City pension funds compare well in the above table.

In addition, the same comparison has been expanded by Program Planners, Inc. to include a large number of private sector plans. The following table shows the ratio of assets to accured liabilities for private pension plans.

Table 1 shows that the New York City pension funds are as well-funded as many private sector pension plans.

With respect to public sector pension plans, the United States Civil Service plan publishes data which can be used in a comparison with the New York City pension funds.

The New York City pension funds pay off past service liabilities over 40 years, a schedule which is permitted by E.R.I.S.A.

TABLE 1.—COMPARISON OF ASSETS TO ACCRUED LIABILITIES OF PRIVATE SECTOR PENSION PLANS

[Dollar amounts in millions]

Pension plan	Total accrued liabilities	Assets	Level of funding (percent)
Allied Chemical	$552	$271	49
Alcoa	1,270	500	39
American Motors	497	137	28
Armco Steel	1,224	650	53
Bendix Corp	865	460	53
Budd Co	425	205	48
Caterpillar Tractor	1,750	1,000	57
E. I. duPont	3,858	2,900	75
Goodyear Tire	1,376	738	54
I.B.M.	3,426	2,700	79
LTV Corp	960	222	23
P.P.G. Industries	632	375	59
Republic Steel	1,492	655	44
Reynolds Metals	671	228	34
Textron	555	394	71
TRW	695	380	55
Uniroyal	921	234	25

Source: 1977 Unfunded Pension Liabilities Investors Management Services Institutional Investor.

The United States Civil Service plan does not pay off its past service liabilities and does not even make a full payment toward the interest that accures on the past service liability. (Since a pension plan assumes that assets will earn income and since past service payments should be made to the plan and are thereafter assumed to earn interest, the failure to pay past service liabilities precludes interest earnings and, as a result, the past service liability grows, instead of diminishes, every year).

The past service liability of the United States Civil Service pension plan has grown by $44.4 billion between 1970 and 1975 and will continue to grow.

In contrast, the New York City pension funds are making regular annual payments to its pension funds in order to reduce and, after 40 years, eliminate its past service liability.

TABLE 2.—*Growth in Unfunded Past Service Liability of the U.S.C.S. Retirement System*

[Dollar amounts in billions]

Unfunded past service liability:	
June 30, 1970	$52.8
June 30, 1975	$97.2
Increase	$44.4
Percent increase	+84

The New York City pension funds have sufficient assets to pay benefits to all currently retired members with excess assets to finance benefits of active members.

The United States Civil Service plan has only $34.4 billions in assets while its liability for benefit payments to retirees is approximately $49.5 billions. In other words, the United States Civil Service plan cannot pay all current retirees the benefits that are due them.

An actuarial valuation of the United States Civil Service Plan, reported in 1975, showed that if the United States Civil Service pension plan financed its benefits on the same basis as the New York City pension funds, then the pension cost of the Federal Government would increase from $4.06 billions to $17.80 billions, an increase of 338 percent.

TABLE 3.—COMPARISON OF ASSETS TO CERTAIN LIABILITIES: U.S. CIVIL SERVICE AND NEW YORK CITY RETIREMENT SYSTEMS

[In billions of dollars]

	U.S. Civil Service	New York City [1]
Liability for retirees	49.5	4.9
Assets	34.3	7.8
Gap	15.2	
Surplus		2.9

[1] At June 30, 1974.

Note: The U.S. Civil Service retirement system required a $15,200,000,000 increase in assets in order to have enough funds on hand to pay all current pensioners. The New York Civil City retirement system had enough assets on hand to pay all current pensions and had $2,900,000,000 on hand to offset the accrued liabilities of active members.

Federal Government contributions to U.S. Civil Service Pension Plan

Basic For Pension Cost Calculation:	*Billions*
Actual	$4.06
NYC assumptions	17.80
Increase	13.74

The increased pension cost of $17.8 billion is equivalent to 10 percent of 1976 Federal personal income tax collections or 80 percent of corporate tax collections.

The preceding comparisons and illustrations demonstrate that New York City pension funds are as well-funded as, if not better-funded than other public and private plans.

The adoption of updated actuarial assumptions, as recommended by the Mayor's Management Advisory Board, will assure the continued sound financing of the New York City Pension Funds.

STATEMENT BY NEW YORK CITY COMPTROLLER HARRISON J. GOLDIN

I appreciate the opportunity to describe the condition of the New York City employee retirement funds and the reasons why these funds and their trustees again require the attention and understanding of the United States Congress.

As you are no doubt aware, the actuarial retirement systems of the city of New York consist of five separate systems, each with its own assets and its own Board of Trustees. Four of the systems are for specific categories of employees: policemen, firemen, teachers and education employees other than teachers. The fifth and largest system has a membership of all other city employees, including those who provide such services as health care, sanitation, welfare and transit.

The five systems had aggregate assets of $9.6 billion as of January 31, 1978. They have combined memberships of more than 330,000 employees in the active category and 107,000 in the retired category. The monthly pension checks sent to retirees and beneficiaries in a recent month amounted to $72 million.

These pension checks go to retirees in just about every state in the Union and to foreign countries as well. More than $8 million a month goes to retirees in Florida and a fast-growing $1 million goes to retirees in California.

The Comptroller of the city of New York has several roles with respect to the pension funds. One role is to serve as a trustee of the various retirement systems, together with other trustees representing the city government and the public employees. The voting procedures are generally designed to insure that neither the government officials, acting as a bloc, nor the employee representatives, acting as a bloc, can by themselves achieve passage of a motion without some support from the other side.

The Comptroller's second role is to act as the supervisory investment manager of the pension fund assets through a delegation of authority by the trustees. The trustees as a group retain the power to approve or disapprove all transactions. They also select the money managers who make investment recommendations on a regular basis and who direct the actual trading.

It is widely known today that a significant percentage of pension fund assets are invested in the city's own securities. What is not so widely known is that this condition is not a new one for the city of New York.

In the early 1960's, under Comptrollers who preceded me in office, the assets of the pension funds were invested twice as heavily as today in city securities. In 1961, for example, when the total assets amounted to $3 billion, some $1.9 billion or 66 percent was invested in New York City bonds.

In the mid-sixties, there began a program to reduce the holdings of New York City obligations. This was accompanied by heavier investments in corporate bonds and the beginnings of investments in common stocks.

By 1974 the corporate bond share of the portfolio was up to 60 percent. Common stocks were 15.5 percent. Investments in the city's own securities were down to about 5 percent.

When the fiscal crisis erupted early in 1975, shutting the city off from the public credit markets, I had been City Comptroller for approximately one year. I participated in the planning which produced a new State agency, the Municipal Assistance Corporation for the city of New York, which was intended to serve as the financing agency for the city.

We soon learned that even the Municipal Assistance Corporation could not command the amount of credit necessary to meet the city's huge needs for cash.

In the fall of 1975, with the State government itself running into serious credit problems, the city and State began to look to the Federal government for help.

As an active participant at the time, it is my clear recollection that neither the city nor the State proposed or urged that the employee pension funds become, in effect, the bankers and lending agents to the city. No one had an interest in seeing the percentage of pension fund holdings in city paper mount again toward the levels of the early sixties.

Rather, the city and State requested of the Federal Government a simple program of loan guarantees or outright loans if such were deemed preferable by the administration and Congress. A bill which would have authorized Federal loan guarantees was approved by the House Committee on Banking, Finance and Urban Affairs and was cleared for a floor vote by the Rules Committee.

There was no specific plan, to the best of my knowledge, for a tapping of pension fund assets.

The Ford administration adopted a position in opposition to Federal guarantees of any kind. In the meantime, during hearings before the Senate Committee on Banking, Housing and Urban Affairs, spokesmen for the city were asked repeatedly why the city did not turn for rescue to its own employee pension funds. The charge was made that the city was seeking what was called a Federal "bailout" while billions of dollars in capital was going untouched in the form of pension fund assets.

While some high officials sought to wash their hands of the city's crisis by pointing to the availability of pension funds, others were actively proposing formal bankruptcy as the best solution.

Finally, as actual bankruptcy drew near in November of 1975, the Federal administration agreed to provide limited seasonal financing help but only as part of a complex and interdependent financing package involving the city employee pension funds as major lenders in the extraordinary amount of $2.53 billion over three years.

Now, in 1978, your subcommittee has asked me to comment on the way in which these loans were in the best interest of the city and the pension funds.

I am reminded of the Frenchman who was asked what he did during the French Revolution and he answered, "I survived."

I was not in 1975, nor am I today, a proponent of the use of city pension funds as central financing agents for the city. But when the only alternative to a certain course of action involves a high risk of disaster, the certain course of action may become the only prudent choice whatever its other drawbacks may be.

Therefore when you ask me, in effect, what good has come of these investments, I can only reply that the city has survived and the pension funds have survived. Would they have survived without the investment program? I do not know and I believe further that nobody knows or ever will know. But prudent men in 1975, including duly elected officials of the city and State, joined and prodded by high officials of the Federal administration and the Congress, decided that when the possible danger was so great it entailed too high a risk to find out.

It was easy to assert at that time—and perhaps equally easy to assert today—that the pension funds, despite whatever their degree of underfunding—were safe and inviolate in the case of any city bankruptcy. Perhaps this is the case, but it is hard to be absolutely certain when the prospect is one of a desolate, helpless, bankrupt, permanently crippled city, unable to maintain normal and essential operations, unable to continue the contributions to the pension funds which are now running at the rate of $96 million a month.

The trustees of the pension systems were in 1975 and remain today men of conscience and responsibility, choosen for their capacity to provide leadership and make difficult decisions. They made the agonizing choice to assume a certain investment risk in order to forestall what appeared to be the even greater risk of a calamitous collapse of the city itself.

Though the city's ultimate recovery—and even its ultimate survival—are by no means assured at this point, the breathing space provided by the financing agreement of 1975 has produced improvements and reforms in the funding of the retirement systems. As Mr. James Brigham, Jr., stated yesterday, major reforms in pension funding, recommended by the commission headed by Richard Shinn of Metropolitan Life Insurance Company, are being implemented on a phased basis. A long-standing impasse producing a serious underfunding of the Fire Department Pension Fund is now the object of intensive efforts toward resolution.

Recent State legislation which restricts pension benefits for newer members of the retirement systems will insure that demands on the retirement systems and on the city itself will moderate slowly as newer members replace the recently retired members. For a more detailed picture of this situation I suggest consultation with the Chief Actuary of the retirement systems, Jonathan Schwartz.

For a report on the general financial condition of the city, which is your second question, I cite the detailed monthly statements which are sent to the Secretary of the Treasury and other Federal officials. They show that the city has made extraordinary progress since 1975 in controlling expenses and reforming most of the dangerous and discredited financial practices that led to the loss of public credit. Although the city will achieve a legally balanced budget as defined by State law in the current fiscal year, it will not achieve a budget balanced in accordance with generally accepted accounting principles until 1982.

A fuller assessment, with which we generally agree, is contained in the public statement of Treasury Secretary W. Michael Blumenthal concerning the city's current status and future needs, issued on March 2, 1978.

It is my considered judgment that if the city continues its process of fiscal reform and restraint and achieves a condition of recurring budget balance by 1982 in accordance with generally accepted accounting principles, it can gradually recover public credit and relinquish the Federal financing help which will continue to be necessary in the meantime.

As you know, all the plans which are currently under active discussion to meet the city's financing needs after July 1 of this year assign a role—varying only in size—to the employee pension funds. The plan incorporating the largest role is the one recently advanced by the Senate Committee on Banking, Housing and Urban Affairs. This plan also assigns a financing role to the pension funds of the State of New York. The Treasury Department has been insistent on a continued major financing role for the city pension funds and a new and sizable involvement on the part of the State pension funds.

As you have learned in previous testimony, the additional investments of the city pension funds in city securities which are scheduled for the final quarter of the current fiscal year will bring the percentage on June 30, 1978 to approximately 35 percent.

Under the city's own proposed four-year plan, the 35 percent would be a peak and future investment levels would result in a somewhat lower percentage as the plan is implemented. Under the plan proposed by the Treasury Department, the new investment pattern to be negotiated with the city pension systems would permit investment levels as high as 35 percent throughout the entire period.

As your committee is aware, Secretary Blumenthal has proposed that Congress amend PL 94–236 to permit city and State pension funds to purchase city or Municipal Assistance Corporation Securities during the 1979–1982 period.

The city of New York endorses this request by the Secretary.

For your information, an extension will also be sought of Chapter 890 of the Laws of 1975 of the State of New York, which grants indemnification to the trustees against lawsuits for investing pension assets in City securities.

The significant difference in the investments which are contemplated by the employee pension systems after July first is that under the city's plan, and also as a likely consequence of the Treasury's plan, the securities to be purchased would carry a Federal guarantee. Obviously such a guarantee is of paramount importance to all who are concerned with the heavy concentration of resources in the securities of a city not yet recovered from its fiscal ordeal.

Indeed, I called the attention of the Moorehead House Subcommittee yesterday to the fact that unless the financing needs of the city after July 1 are securely provided for it may very well be impossible for the trustees of the city pension funds to make the almost $700 million in purchases which are scheduled for April, May and June of this year. With an acute consciousness of our fiduciary responsibility, it is hard to conceive that major new loans by the pension systems could be approved by other trustees or by myself if there has not been some reassuring sign by the Congress that essential and adequate financing help in the form of long-term guarantees will be made available after July 1.

While we understand the particular role and function of this distinguished Subcommittee, we hope that in responding to your invitation to testify we may also seek your help as Senators in resolving on a timely basis the broad question of Federal financing assistance to New York City in the years directly ahead. We acknowledge that the city could not have survived since 1975 had this subcommittee and others not been supportive in our time of crisis. We ask your continued support so that the sacrifice and struggle of the past three years will not be wasted but will instead produce the sound and self-sufficient city which is our common objective in the national interest.

Senator BENTSEN. Our next witness will be Mr. William Withers, who is the president of the New York Teachers Pension Association. Mr. Withers?

Mr. Withers, if you would seat yourself by one of the microphones and present your statement, we would appreciate it.

STATEMENT OF WILLIAM WITHERS, PRESIDENT, NEW YORK TEACHERS PENSION ASSOCIATION

Mr. WITHERS. I might say in advance that I am a retired professor of economics from the City University of New York where I have taught since 1937 and I have written 13 books mostly on finance, and therefore I feel somewhat confident to talk about some of these matters.

Senator BENTSEN. And you have a position, do you, representing retirees?

Mr. WITHERS. Yes; I am president of the New York Teachers Pension Association which is incorporated and which is an organization consisting mainly of retired city college professors.

Senator BENTSEN. All right, Dr. Withers, thank you very much. You may proceed.

Mr. WITHERS. I want to read, very briefly, a statement. I must say that I was not really informed of this hearing soon enough to really become properly prepared, but I will do the best I can.

There are over 23,000 retired teachers in New York City, a third of whom receive pensions of less than $4,000 a year and I am speaking on their behalf. Since the beginning of New York City's acute financial difficulties late in 1975, these pensioners and thousands of other city pensioners have not been represented, or their views heard.

Yet, their pensions have been put on the bargaining tables by union and public officials without sufficient consideration of the effects such action has had on the solvency of the pension systems.

The use of pension funds to purchase city bonds has already seriously jeopardized the solvency of these systems. To require further purchase of city bonds will bring them close to bankruptcy, in my opinion.

Unlike 600,000 other public and private pension systems in the United States, either under ERISA or under the rules of the Internal Revenue Service, they are no longer required to invest only 10 percent or less in the securities of one corporation or public agency or to buy only securities of high investment rating.

They were exempted from the personal liability incurred by all other trustees in the United States for the infraction of these rules by the New York State Legislature and by the Congress.

The pensioners in New York City have been denied their constitutional right to equal protection of the law, and we have a case before the courts right now charging this.

Moreover, New York pensioners, as well as being shorn of trusteeship protection are not politically represented. Their trustees are not elected by retirees, only by active employees. Even the election of these trustees by the active employees is a farce, amounting virtually to their appointment by union leaders. Thus, the trustees become merely representatives of these union leaders and the granting or withholding of pension funds becomes the tool of collective bargaining.

Use of the pension funds has threatened their solvency because over 40 percent of the assets are now in unmarketable city bonds. For example, as of December 31, 1977, 41.48 percent of the assets to the fixed annuity program of the teachers retirement system was invested in city securities figured at par value and in Capehart FHA, in rem and conventional mortgages, 1 percent, also listed at par.

The total par value of the fixed annuity fund was $2,486,726,804, of which $1,533,695,601.61 was the value of the noncity assets.

Now, how much actual value then existed in the teachers retirement system at the end of 1977 to buy additional city bonds? The noncity assets, as indicated above, amounted to a little over $1.5 billion at par value. What was their market value?

The teachers retirement system does not compute this. The New York Teachers Pension Association, Inc. estimates that the marketable fixed assets as of December 31, 1977 were worth $1.2 billion.

Senator BENTSEN. I am going to have to interrupt, because I want to have it in context. I want what you are relating to there, when you talk about the marketable fixed assets as of December 31, 1977 worth $1.2 billion on market value if sold in small amounts, that relates to what kind of a par value?

Mr. WITHERS. It relates to par value of approximately $1.5 billion.

In other words, there is $300 million less than they are estimating it at par value.

If they could then have been sold gradually and in very small amounts, but if these assets had to be sold in large amounts of $100 million or more at a time, the fund, in our estimation, would amount to only $900 million. In other words, you cannot sell a lot of securities of this sort without considerable discount. And as of 1966, June 30, 1966–1976, rather, June 30, 1976, the losses from the sale of these assets in the teacher's retirement system amounted to $158 million.

In other words, to get something like $576 million to give to the city in selling the good assets of the teachers retirement system, the loss amounted to $158 million. In other words, if you start using these pension funds to obtain money to buy city bonds, you have to sell good securities to buy these worthless city bonds, and that means that you make losses and you accumulate losses which were accumulated by the middle of 1977 to the amount of $158 million. And these are the figures given in the annual report for 1976 of the teachers retirement system, so they are not estimates of mine. And as of now, these losses have not been amortized at all.

The income of the fund, moreover, even with the high interest paid on the holdings of city and MAC bonds was not enough to pay the pensions of retirees, let alone providing any funding for future retirees. They are not funding the system at all, in spite of what they are telling you.

In fiscal year 1977, the annual income of the fund—now I am referring to the teachers retirement fund—consisting of interest on the fixed assets was $137 million, but the amount needed to pay the pensions of those already retired was $228 million.

At the beginning of this year, the teachers retirement system was almost halfway to the bankruptcy of the city firemen's retirement fund. Bargaining away funds of a pension system which is already 40 percent unfunded for present retirees is like using a half-dead horse as an asset.

The public was told in November 1975 that if the city's pension systems bought $2.5 billion in city bonds it would save the city from bankruptcy. Having the pension funds use over 40 percent of their assets to buy these bonds did not insure the city's solvency at all.

By 1978, the city was almost as near bankruptcy as in 1975. Would using 100 percent of the city's pension funds insure solvency? We think not.

The pension funds provide no realistic solution to the city's financial difficulties. Their use merely results in threatening another type of bankruptcy, the bankruptcy of the pension funds. Worse yet, it violates State law which requires that the pension system be funded.

They are not being funded. They are being converted into pay-as-you-go systems, and to do this, it is even an illegal abrogation of contracts since, under New York State law, a pension is a contract involving the creation and segregation—and the important word here is "segregation"—of a life annuity at the time of retirement through the process of funding. But legality and constitutionality have been abandoned in favor of expediency.

The administration of New York City is riddled with inefficiency. The unions exert pressure for higher wages even when the city is almost bankrupt. The New York banks have been unwilling to risk very much to buy city bonds. Why should old, retired pensioners earning $4,000 a year without any cost of living supplements to speak of, only one in 10 years, why should these old, retired pensioners carry the burden of saving New York City?

Have they not done too much already, or are they just old people who can be taken advantage of?

I have been kind of violent, but I feel awfully violent about this. We have been saying it for 2 years and we have been fighting this for 2 years in New York City, you listen only to the union leaders.

Senator BENSEN. You are getting one right now, Dr. Withers, and we are delighted to have you here because we wanted very much to hear from the retirees and you have presented testimony that will be very interesting to us and helpful in our deliberations.

I want to reiterate my concern about conflicts of interest, the position that the trustee is placed in. Now, the reason that we passed in the Congress Public Law 94–236 was specifically to waive the prohibitions against conflicts of interest because of the problems that New York City faced. And the Senate and the House at that time said otherwise they were going to be subject to IRS provision 503(b) on conflicts of interest.

But I am trying to find some way that we can resolve that and see that the retirees have somebody representing them who are not under two masters.

Do you have any recommendations in that regard?

Mr. WITHERS. Well, one recommendation is that in making these decisions the fiduciary responsibility that the trustees have toward the retirees should be considered and should be heard. It seems to me that under the laws of New York State—I do not know how this applies to other cities or municipalities, but there is no question in my mind that under these laws when a person retires in New York City he has been told and he does believe—and he has been told this for 20 years—that when he retires the law requires that an amount be set aside in the annuity reserve fund for his pension which is equal, according to actuarial calculations, to the amount needed to pay his pension for a lifetime.

Now, this is what the law requires and the law is being violated. Right now, for example, there are $50 million that are unaccounted for—really, unaccounted for—in the reports of the teachers retirement system. We have been trying to find out, for the last 3 months, where this money went to. But the latest figures that we can get out of our own retirement system are as of the middle of 1976. In 1976, not 1977.

And one of our problems is that there is a conspiracy of secrecy here, that the pensioner is not told, even though he is dependent upon these pension funds, what the true status of his system is. You cannot get figures that are valid.

Senator BENTSEN. We drafted that under ERISA for the private pension plans, but we took care of it. It ought to have those kinds of disclosures under the public plans.

Mr. Withers, I would like to continue, but I yield now to Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I see that the Senate has gone in and we are obliged not to hold these hearings while the Senate is in session.

I would just like to thank you, Dr. Withers, for a very interesting testimony. It grabbed my attention, certainly.

I began life at the City College and joined the Navy in 1943. Otherwise, I might have been one of your students. I might have learned economics in preparation for this committee.

Do I understand, sir—just one question—that the teachers of the City University are in the same pension system with the schoolteachers?

Mr. WITHERS. Yes.

Senator MOYNIHAN. I thank you very much.

Mr. WITHERS. I would like to say one more thing. We believe that there should be passed by the Congress a bill for public pensioners similar to ERISA. We have been working for that for 2 years.

We do not think that it can be exactly the same as ERISA, because there are different problems, but we supported the Dent bill, for one thing. We did not think that was adequate, but we did support it.

Senator BENTSEN. Dr. Withers, we would be pleased to have you buttress your statement with additional testimony, if you desire, in writing. Thank you very much. You have been very helpful.

Mr. WITHERS. Thank you, Senator.

[Thereupon, at 12 noon, the hearing in the above-entitled matter adjourned.]

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