

DOMESTIC MARKETS NEWSLETTER

New Default Crisis Builds in New York City

After nine months of banker rule, New York City is closer to default than it has ever been. The Emergency Financial Control Board's mid-February report to Treasury Secretary Simon, which covered the period inclusive of December 1975 revealed that in calendar 1976 the city must meet \$3.144 billion in debt service payments — over 25 per cent of the fiscal 1976 budget! At any point this spring the MAC-EFCB operation of bleeding municipal services to meet the ever ballooning monthly debt service payments could give away — provoking the final collapse of a pyramid of \$12 billion in outstanding New York City debt.

This situation is being kept quiet by the Mutual Assistance Corporation (MAC), the EFCB, and the New York bankers they represent. Two weeks ago however when MAC Chairman Felix Rohaytn said he was considering offering holders of the \$1.1 billion notes in moratorium another chance to swap their notes — which are still costing the city over \$200 million in interest a year for long-term MAC bonds, he was thinking about averting an inevitable cash-flow crisis in the next few weeks.

How is it possible that New York City is paying more debt service and closer to default than before the creation of Big MAC? Felix Rohaytn and the other creators of MAC said it would solve the city's debt crisis by relieving the city of the pressure of continually having to roll over short-term debt at skyrocketing interest rates. MAC would use its own good credit rating to convert the city's short-term debt into long-term MAC bonds.

In the spring of 1975 the New York banks were forced to recognize that there was no possibility of the city making good on its more than \$6 billion in short-term obligations — under prevailing political conditions. The banks at that point decided that they could no longer refinance the city's burgeoning — and worthless — short-term debt with no hope of repayment. They created MAC, a dummy corporation whose real function was to secure value for the city's worthless debt. The idea was to use MAC's political clout to enforce drastic budget cuts and ensure that liquidity would be diverted from municipal services to debt service. One of the main selling points of MAC bonds was their first lien on revenues from the city sales tax and stock transfer tax. The stock transfer tax, specifically created to back up MAC bonds, has already been repealed as a result of lobbying interests.

Aside from this political purpose, MAC represented a pure accounting swindle. Some of the maturing short-term notes were actually paid back out of the proceeds of the sale of MAC bonds; as for the rest, banks holding maturing notes "purchased" MAC bonds and were paid back with their own money. In reality the banks merely swapped pieces of paper, while keeping the book value of old unpaid debt on their books and the worthless MAC paper as assets.

As a result of this swindle, MAC created \$2.3 billion more illiquid paper that had to be secured through escalating budget cuts. New York's debt continued to grow: at every

point the city edged close to default on maturing debt, more debt was issued at higher interest rates, adding to the pyramid of illiquid paper, as bankers demanded more austerity to provide the illusion that the MAC paper was worth something.

Exponential Growth of Debt

Last June city politicians had the choice of declaring a moratorium — a full moratorium on interest and principal — on the city's huge debt, or submitting to Big MAC — the refinancing of an increasing mass of debt by cutting vital services to the bone.

The imposition of stringent austerity by Big MAC — in the context of a general depression of the world economy — led to an unprecedented contraction of city revenues. The contraction of revenues, together with the increase of costs associated with unemployment and the general rate of inflation, has led to an uncontrollable explosion of the city's revenue-expenditure gap — which in turn leads to the need for more austerity and more borrowing — and a larger deficit. In the course of this vicious cycle debt service costs zoom up, eating up more and more of the city's real income and exacerbating the fiscal crisis.

The city's own figures demonstrate the growth of debt service during MAC's nine month tenure. Over 1976 the city will pay:

- * \$234.2 million in interest on notes "in moratorium;"
- * \$1.33 billion in amortization of long-term debt;
- * \$2296.3 million in repayment of interest and principal on notes floated by the state on behalf of the city;
- * \$952.2 million in interest and "takeout" (repayment of principal) on MAC bonds.

The only thing that has kept the city from defaulting on these payments until now has been its line of credit from the Treasury. As of March 1 the city had borrowed \$1.19 billion from the Treasury in short-term "seasonal" loans. As the city's sales tax revenues have flowed directly into MAC's account, the Treasury loans have provided the city with cash to operate while cash revenue was diverted to debt service. Under the legislation passed by Congress last December, the city can borrow up to \$2.3 billion a year over the three year financial "reorganization," paying it back on June 30 each year. On March 1 it was the Treasury's determination that there was "reasonable" assurance that the city would be able to pay back the Treasury at the end of this fiscal year; however, it is inconceivable that this can be done given the city's galloping deficit — even with massive budget cut-backs. Political resistance to additional austerity is growing, as reflected in recent moves toward debt moratorium by city councilmen, state legislators and New York Congressmen. These representatives realize that further compliance with the banker's demands for more austerity will leave them without constituencies. The threat of politically enforced debt moratorium is making the bankers ever more nervous

about the "value" of their 12 billion in city paper. Rohaytn, presidential hopeful Senator Henry Jackson, and other Democratic party figures are hoping to get a drive going for a "Marshall Plan for the Cities" — a national Big MAC which would put the federal government and its clout behind the more that \$225 billion in outstanding state and municipal debt. As described by Rohaytn, such a scheme would necessarily involve "moratoria" on currently unpayable

debt, the federal guarantees that New York's MAC was unable to secure for its bonds from the Congress, and centrally coordinated austerity and slave labor projects.

But action on such a plan is a long way off. In the meantime, though no city or MAC official will comment on it, the city may enter a default crisis at any moment.

IPS will issue a more comprehensive report on the New York and other municipal crisis in next weeks edition.