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The Honorable Henry Paulson, Jr.
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Secretary Paulson and Chairman Bernanke:

In response to the credit crisis and the enactment of the Emergency Economic Stabilization Act by the Congress, the Treasury Department and the Federal Reserve have taken bold steps in recent weeks to create several new programs related to stabilizing the financial markets and facilitating the access of private companies to credit. The credit crisis, however, has also now significantly affected the municipal finance markets, and the Treasury Department and Federal Reserve must do more to support the ability of states and localities to issue bonds and access credit. I therefore urge you to use your existing powers and new initiatives, including the Troubled Asset Relief Program and the Commercial Paper Funding Facility, to help states and localities during these difficult times.

The municipal finance markets have experienced considerable turmoil during the past year. Last winter, many of the insurers that guarantee the bonds issued by states and localities began to falter, resulting in higher borrowing costs for many issuers. Several months later when the problems in our financial system seeped into the auction rate securities markets, many states, authorities, and localities found themselves having to pay significantly higher short-term interest rates, in some cases as much as 20 percent annually on bonds that typically paid 4 percent. The bankruptcy of Lehman Brothers, one of the largest purchasers of government bonds, added to these financing woes.

September's credit crisis has further aggravated this situation. One report found that officials put on hold about $15 billion in planned municipal bond issuances in September due to market conditions. Municipal Market Advisors has also determined that the average interest rate for seven-day debt issued in the municipal bond market stood at just 1.79 percent during the week of September 10, increased to 5.15 percent for the week of September 17, and jumped to 7.96 percent for the week of September 24.

Spending by states and municipalities amounts to 12 percent of Gross Domestic Product. Consequently, any contraction in spending by this sector of our economy will result in a worsening of our present economic situation. States and localities need access to money now so that job-creating infrastructure projects can begin without delay. Additionally, officials in state capitals, county seats, city halls, and town councils need federal help in obtaining access to credit in order to meet payroll obligations, provide the public safety services that all Americans rely upon, and address other important societal needs.

The National League of Cities reports that there are three major concerns for state and local governments right now. First, there is an immediate need for short-term access to cash. States, cities, and towns need access to cash to pay the men and women who police our streets, teach our children, and collect our trash. Very often, state and local governments depend on short-term credit to float between revenue streams. Until recently, the State of California tinkered on the edge of needing $7 billion in short-term federal assistance to maintain its government operations. Moreover, Jacqueline Byers, the research director for the National Association of Counties, an organization that represents 3,066 counties, recently noted in the Wall Street Journal that "there are examples every single day of counties hitting the wall."

Second, there is a medium-term concern that market turmoil is curtailing cities' and states' ability to borrow money for ready-to-go projects like roads and bridges. These projects create jobs, and we need to start them as soon as possible. The State of Maine in September was unable to raise $50 million for previously planned highway repairs. In Northeastern Pennsylvania, Wilkes-Barre's Mayor Tom Leighton has informed me that the turmoil in the bond market could affect upcoming projects there, too.

Third, there is a long-term need for state and local governments' sources of revenue to move in the right direction. Revenue from income, property, and sales taxes make up a large portion of the money used by states and local governments to pay for day-to-day needs. These revenue streams are, of course, related to what happens in the broader economy. As the value of homes continues to decline, the sale of new homes slows, the unemployment rate rises, and consumer spending decreases, these revenue sources are diminished.

During the Financial Services Committee hearing about systemic risk in the financial markets on July 10, I asked both of you whether you needed additional emergency powers to respond to the growing problems in our economy. Initially, you indicated that you did not. Shortly thereafter, however, the Treasury Department sought and the Congress provided new powers for the government to create a liquidity backstop for Fannie Mae and Freddie Mac. At your urging, the Congress also now has passed the Emergency Economic Stabilization Act. Along with other initiatives undertaken by the Treasury Department and the Federal Reserve, the programs put in place by these new laws will hopefully succeed in restoring stability to our financial markets as soon as possible, but until then we need to be prepared to come to the aid of our states and local communities.

As a result, I urge you to determine how you can use your previous powers and new authorities to help state and local governments. By thinking innovatively, the Federal Reserve could use the new Commercial Paper Funding Facility to provide liquidity to state and local governments. The special purpose vehicle, or another corporation, could purchase the short-term obligations of municipalities if they come under distress and seek help. In implementing the Troubled Asset Relief Program, the Treasury Department should also work to find ways to help state and local governments.

If after reviewing your existing powers you determine that you need more legal authority to address the credit access problems of states and localities, then I urge you to request it from the Congress immediately. I have read reports that the Federal Reserve may not be legally able to serve as the lender of last resort for states and localities and that provisions in the tax code limit the ability of the Treasury Department to guarantee the tax-exempt municipal bonds. If so, the Treasury Department and the Federal Reserve need to promptly advise the Congress of any legal barriers or statutory needs, so that the Congress can take action as soon as possible to fix the situation.

In sum, at a time when financial institutions and commercial corporations are receiving extraordinary help directly from the federal government, we cannot turn our backs on states and localities. Municipalities fund job-creating, community bedrock projects like roads, bridges, schools, hospitals, sewage treatment plants, and libraries, in the credit markets. We need to ensure that they continue to have access to the money that they need in the months ahead.

To that end and consistent with all applicable law and regulation, I urge you to engage with each other and other appropriate entities to find new ways to help state and local governments to meet their credit needs. Moreover, as the Congress is now working on an economic recovery package, I request that you alert me no later than close of business on Thursday, October 30 about any statutory changes needed to enhance the ability of the federal government to assist states and localities during this credit crisis.

Sincerely,

Paul E. Kanjorski

Paul E. Kanjorski
Chairman, Subcommittee on Capital Markets,
Insurance, and Government Sponsored Enterprises

cc: The Honorable Nancy Pelosi
Speaker
U.S. House of Representatives

The Honorable Steny Hoyer
Majority Leader
U.S. House of Representatives

The Honorable Barney Frank
Chairman, Financial Services Committee
U.S. House of Representatives