

**Senate and House Democratic Policy Committees  
Joint Hearing**

**“The President’s Budget Request for Fiscal Year 2004”**

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Mr. Chairman, Members of the Committee

I feel privileged to be here and to be able to comment on the administration’s budget and economic policies. I have made no secret of my conviction that our economy is dangerously weak, and that the current plight of our cities and our states urgently requires financial assistance from Washington if our national economy is to recover. The administration and the congress need to create such a program in order to have any chance to put the national economy on a sound footing; America, after all, is the sum of its parts. Its states and its cities should be our top domestic economic priority; the administration’s budget is totally silent on this point.

Today, America is gearing up for war on a shaky domestic platform and an exposed international posture. Our economy may be near a recession; unemployment is high; investment is down; the stock market is down; the dollar is down; the federal deficit is soaring. Every business leader I speak to nowadays tells me that business is bad across the board. Overseas, the economies of Europe and Latin America are very weak, which hurts our companies whose overseas operations generate 30% of their earnings. The winds of deflation combined with arms proliferation (a lethal combination) are blowing world wide, and wherever one turns one sees growing security dangers: in addition to Iraq, Pakistan and North Korea flaunt nuclear weapons and missiles, Iran is not far behind, Middle East terror groups such as Hezbollah and Hamas may spread their actions abroad and bin Laden and Al Qaeda are still active. Equally large economic risks exist: Brazil, Argentina and Japan to mention the most important ones. And, after saving global peace three times in the 20<sup>th</sup> Century, America is now seen as more of a threat than a protector by too many of our allies and, despite supportive letters by several European leaders, NATO itself is divided about supporting us on Iraq.

America needs a stable and prosperous domestic platform to face these challenges; it cannot do so unless our economy is strong and our cities and our states are stable, prosperous, and safe. This will require two types of federal support. First, a \$75 billion annual program of budgetary assistance to state and local governments aimed at offsetting \$70-80 billion of local tax increases and spending cuts presently scheduled to close local deficits. These, unless attended, would eliminate any possibility for economic growth in the near future. Such a program, similar to President Nixon’s revenue sharing initiative of the 1970s, could be phased out after 3 years if and when the national economy recovers. This should be combined with a \$75 billion reduction

in the payroll tax in the coming year. The elimination of the double tax on dividends, proposed by the administration, is both expensive and ineffectual; it should be dropped. It is, essentially, an attempt to prop up the stock market by a few percentage points at a huge long-term cost. It would require over \$300 billion over 10 years. Rather a 3-year package that would assist local governments by direct budget assistance, and provide early tax relief to Americans at middle-income levels, is more likely to provide real stimulus to the economy. I was happy to see that Senators Chuck Schumer and Olympia Snowe have come out with a proposal for assistance to states and cities along similar lines, as has Senator Tom Daschle, although on a more modest scale. However, I believe that real economic stimulus will require more time and more generous financing to be effective.

Assistance for infrastructure is also very important. It is a longer-term issue. Three years ago, I was given a "Report card on America's Public Infrastructure" prepared by a respected group of civil engineers. The report card indicated a potential requirement of \$1.3 trillion to bring America's infrastructure up to minimal acceptable levels. It was a sad reflection of our national priorities that the physical state of our schools was the lowest of any category on this list and ranked below the state of our sewers. And this was before 9/11 and the added requirements of homeland defense.

Infrastructure and public investment are an important component of the national economy as well as to national security. Public investment is needed to balance flagging private investment. Presidents from Abraham Lincoln to Dwight Eisenhower have promoted federal investment in infrastructure from transcontinental railroads to power dams and to interstate highways. They have done so to promote the domestic economy as well as domestic security. State and local governments now have less and less credit capacity to finance such investments, and municipal credit ratings will be lowered all over this country in the next year or two without further federal assistance and a better economy. A federal program of credit enhancement, through guarantees or leases, could free up tens of billions of pension fund assets to finance this type of investment; it should be developed as an alternative to direct government borrowing and its budget impact.

The requirements of homeland defense (harbors, airports, tunnels and bridges, etc.) make this a more immediate issue. It is also worth noting that public investment is very job creating. For instance, \$35-40 billion invested in public transportation infrastructure is estimated to create one million jobs. A five year \$250 billion infrastructure program is bound to create several million jobs, which our economy will urgently require. It could mobilize assets of public pension funds, and would take into account their fiduciary needs for prudence.

Our economic problems are likely to become worse before they get better. The fear of war and the uncertainties connected with it are adding to the weakness of the economy. I believe that the projected deficits of both New York City and New York State will exceed their present estimates of \$3 billion and \$10 billion respectively. Governor Pataki's recent budget is a clear indication of this degradation as it significantly increased the potential city deficit and the trend is likely to be similar in the rest of the country.

Much of this was caused by the downturn of the stock market, and the problems of our financial service sector as a result of the various financial scandals of the last two years, along with the

recession itself and the impact of 9/11. The strength of our financial markets is critical to our economy in order to attract the more than one billion dollars per day we require to finance our foreign trade deficit. The current weakness of the dollar combined with the weakness of the markets is an ominous combination for the future. Which brings me to our federal budget and its deficits.

I believe in budget discipline but I do not believe that you can retrench your way to prosperity. It took us four years after the New York City crisis of 1975 to balance our budget, in order not to tear the city apart. Economic growth balanced our budget, along with spending restraint; but the growth was the key factor. For the following 25 years we kept the New York City budget in balance, until the recent national crisis. I have no qualms about temporary increases in the federal budget deficit for programs such as I discussed here. Healthy cities are necessary for a healthy national economy and infrastructure investment is job creating, necessary to our safety, and will, over time, pay for itself. Our publicly held national debt, at about 33% of our GDP, is significantly below the 60% limit set by the European Union for its members, and temporary deficits of 3-4% of GDP, in a period of recession and probable war, are acceptable. We cannot, however, tolerate permanent increases in the deficit beyond a certain point.

The Bush administration's budget harks back to the early Reagan budgets of the 1980s with deficits "as far as the eye could see." These deficits, driven by defense spending and tax cuts, were later dealt with by "rosy scenarios" and tax increases. Now our new security doctrine of preemptive war and unquestioned global military dominance has created a budgetary situation that could be difficult to finance in the long run. By choosing absolute military dominance instead of collective security as our basic doctrine, we are committed to significant and continued large-scale increases in the military budget. Current trends in military spending, growing at about 5% per annum, will require about \$2.5 trillion over the next 5 years. This, without factoring in the costs of a probable war in Iraq and its occupation and reconstruction costs, which could amount to tens, or even hundreds of billions of dollars. Energy independence, another security imperative, may also require large future investments.

To finance such requirements while maintaining appropriate support for domestic social needs would require very high levels of national growth which may not be realistic; they would require politically unpopular solutions. These would be difficult tradeoffs between wealth and fairness, between consumers and investors, between isolationism and internationalism. Military spending at projected levels would be facilitated by the maintenance of the estate tax instead of its elimination. Energy independence is more likely to require an oil import fee than tax deductions for SUV's. Stronger financial markets require real commitments to new regulatory oversight instead of returning to business as usual. We can already discern some of these issues in Congressman Rangel's suggestion of a return to the military draft (which I support) and the administration's proposed elimination of the double tax on dividends and elimination of the estate tax (which I oppose). Maintaining the estate tax at present levels as well as the dividend tax, would replenish the 10-year budget outlook by \$1 trillion. That would make a huge difference in financing needed programs such as discussed here.

These are tomorrow's problems but we should begin to debate them soon. In the meantime, we must deal with today's problems, the weakness in our economy and the crisis in our cities and

our states. We cannot tolerate a situation whereby we simultaneously spend hundreds of billions to fight a war in Iraq as part of a necessary global fight against terrorism, while having to consider layoffs of policemen in New York because of local deficits. The war against terrorism abroad cannot be allowed to defeat our war against terrorism at home. And, while supporting our military abroad, we must support our cities and our states as an equally important factor in our national defense and our economic strength.

Thank you.