

**Statement by Felix G. Rohatyn
to the
House Committee on Financial Services
United States House of Representatives
March 23, 2007**

Mr. Chairman, Members of the Committee,

It is a privilege to be here today to discuss a critical issue—the need for large-scale public investment in projects that will modernize our nation and enrich our people.

Throughout our history and until the 1960's, the Federal Government played a dominant role in our level of public investment while the states played a secondary role. This has changed since then. Public investment has, by tradition, meant infrastructure: roads, trains, bridges, public transportation, public schools, etc. have provided the private sector with the complementary investments which improve business productivity, our standard of living and our quality of life. Largely the product of a federal-state-local partnership, it was badly neglected over the years, principally by the failure of the Federal Government to maintain its level of participation.

The American Society of Civil Engineers has estimated that it would take one trillion six hundred billion dollars, over a five-year period, to bring America's infrastructure to a reasonable standard of adequacy and that this requirement increases by about \$300 billion every two years.

Mr. Chairman, I have for many years recognized our government's historic role as the indispensable investor in the economy of our country. I hope that your support will encourage the Congress to undertake the major effort needed in rebuilding America before it is too late. In order to do so we must counteract the present theology that all public investment is wasteful, and that neither taxes nor borrowing can be justified for

that purpose. It also is worth noting that the financing of public infrastructure creates hundreds of thousands of private sector jobs; this is particularly important when globalization is putting pressure on American industrial employment.

Fortunately, past American political leaders did not always think this way. As we look to our nation's future, we also should look back at the history of great public investments—at the precedents set by leaders who made many of the critical commitments that became the backbone of our nation. We should reflect on the actions of those leaders who used government power and public finance to make the investments that formed this country. And we should celebrate their historic achievements by continuing to invest boldly and wisely in America's future.

As the political, geographic and economic structure of America took shape in the nineteenth and early twentieth centuries, public investments such as the Louisiana Purchase, the Erie Canal, the Transcontinental Railroad, the RFC and the Interstate Highway System shaped our economy and our security structure. Although the private sector has been the mainstay of our economy, it could not exist without this platform and the political leaders who made those decisions—Jefferson, DeWitt Clinton, Lincoln, FDR and Eisenhower.

Since the beginning of the Republic, transportation, infrastructure and education have played a central role in advancing the American economy: whether it was the canals in upstate New York or the railroads that linked our heartland to our industrial centers; whether it was the opening of education to average Americans by land grant colleges and the GI Bill making education basic to American life; or whether it was the interstate highway system that ultimately connected all regions of the nation. This did

not happen by chance but was the result of major investments financed by the federal and state governments over the last century and a half. Mr. Chairman, we need to make similar investments now.

Of course, not all government investments have been successful. The endless earmarks, political “pork” in too many projects and corruption in military contracts, the reoccurring problems of NASA and many others, are proof that there is no such thing as perfection in the public sector any more than in the private sector. But the private sector has also had its Enrons and its Worldcoms, as well as its earlier scandals which caused Teddy Roosevelt to break up the trusts and FDR to regulate the securities markets. But the consistent ideological attack on public investment is bringing the country to its knees. Witness the outrage of New Orleans. Witness the state of our public schools. Witness our pollution and our wasteful use of energy. Without adequate levels of public investments, our private sector will lose much of its competitiveness and outsource more and more of our requirements in goods as well as services, constantly increasing our foreign debt and losing domestic jobs. The recent decades have been the best of times for private investment; for public investment, they have been disastrous.

My views on economic and social issues have been shaped not only by my years in business and in government, but also by my experiences as a child and as a refugee, fleeing from the Nazis and seeking asylum in America during WWII. In 1942, we arrived in America; I was 14 years old. During the war years I had, from time to time, heard FDR’s voice on the radio, sometimes on clandestine sets, which shaped, almost by osmosis, my views of America. To me, America was the platform for freedom, fairness and opportunity, and I have never wavered from those views.

My involvement in public life began In the spring of 1975, when for reasons too numerous to list here, New York City was caught in a financial death spiral. In the 1960's the City had lost 300,000 private sector jobs that had been replaced by an equivalent number of public-sector employees, together with the sharply-increasing budgetary costs that it entailed. In the early 1970's, the City's economy had slowed sharply during a national recession aggravated by the Arab oil embargo; our capital investment program had been wiped out, the City was shut out of the capital markets and headed for bankruptcy. To regain market access we needed a plan which would revive the City's economy, eliminate its operating deficit and revive its moribund capital investment program. We needed a plan, with Federal backing.

In the summer of 1975, when Governor Hugh Carey appointed me Chairman of New York's Municipal Assistance Corporation, I believed that bringing the City back to the market would take a few months; it actually took several years and required the courageous political leadership of Governor Carey and Mayor Ed Koch; the strong support of the City's labor unions and its banks; and ultimately, it required credit from the Federal government in the form of seasonal loans. The Federal Credit support enabled the union pension funds and the private financial institutions to bring their own support to the financing of the city and as a result, the City balanced its budget over the next four years, reentered the financial markets and, for the next 20 years (with the exception of the recession after 9/11/2001) the City's economy was strong, its budgets were balanced and it was able to make the necessary investments in its infrastructure. It was also able to regain its global attraction for business and for tourism, while surviving the tragedy of 9/11. It could not have happened without the credit support of

the Federal government and the sacrifices of its citizens. It is worth noting that the city repaid 100% of the principal and interest owed to the Federal government ahead of schedule, and that the Federal government did not have to face the staggering national cost of a New York City bankruptcy.

Today, support for any government intervention in the economy has become anathema and this has frightened too many Americans into ignoring the long and positive history of government investment in our land. Furthermore, the illogical rules of government accounting and the fear of further deficits make this a very difficult political issue. As opposed to businesses, states and local governments, the Federal Government accounts do not differentiate between long-term investment and everyday operating expenses. They treat construction of a dam as if it were a welfare check and record the debt incurred as a deficit, without the offsetting asset represented by the dam. If our private sector companies were to keep their books in this fashion, they would report losses instead of profits, they would cut back in investment and employment in order to show fictitious earnings, and would ultimately go out of business.

The idea that government intervention in the economy is always bad has had consequences. The recent catastrophe of New Orleans was an event waiting to happen. If not in New Orleans, it would have happened somewhere else. It is the result of a national failure to make public investments adequately and intelligently—in the case of New Orleans inadequate investment necessary to prevent the flooding of New Orleans, and the failure to have in place an effective emergency response system.

Modern market capitalism and the links of the financial markets to advanced information technology have created a formidable engine for the creation of wealth and we have, in my judgment, the best economic system in the world. This wealth, however, is heavily weighted toward the private sector and has resulted in the neglect and the decay of public facilities, including that of our public schools. The sensitivity of the financial markets to government spending became a powerful brake on public investment because the arbiter of financial policy is a government accounting system that treats investment as an expense and a bond market fearful of deficits regardless of their origins.

The combination of these notions, namely that government cannot do anything right and that long-term public investments are the equivalent of welfare payments, has caused a steady erosion in federal funding for infrastructure and other initiatives that would spur progress and economic growth, leaving more and more to state and local governments which cannot provide adequate support. That is the road that led to New Orleans.

As we fail to make large public investments in our nation's future, the rest of the world is rapidly catching up with us. For example, China has announced an ambitious railway modernization plan increasing their national track network to 62,000 miles and dedicated high-speed passenger lines to 7,400 miles. They plan to spend about \$200 billion in the next five years for rails, equipment and rolling stock. China is equally aggressive in its projected investment in nuclear power as well as in bridges, roads and airports. With foreign exchange reserves of over \$1 trillion and continued surpluses for the foreseeable future, China will have capacity of massive investment which may make

her the leader in the world in nuclear power, civil aviation, highway construction and railroads and, most importantly, education. China is not alone in this; India is not far behind.

A federal capital budget would help correct our problem. You all know the political hurdles facing the passage of such a budget, but their existence should not automatically doom the idea. After all, all fifty states have capital budgets, as do most responsible governments, and it may be time to insist on similar fiscal responsibility in Washington. If, in the end, we are unable to institute a capital budget, there is a recent development that suggests another remedy: the return of the 30-year Treasury bond. Long-term bonds should finance capital assets and their issuance should be dedicated to that purpose. Even longer maturities than 30 years can be envisaged; corporations and governments are issuing up to 50-year bonds. The European Union, for instance, finances its superb high-speed rail network with the European Investment Bank's long-term bonds.

To help deal with our shortage of capital investment, the Congress could authorize a trust fund, to be financed over a five-year period by special purpose 50-year Treasury bonds. The fund could be used to co-finance high priority national, regional and local tangible infrastructure programs, as well as special projects which generate advanced intellectual property. Private capital should be an integral part of the program. Tight outside controls should be applied to the operations of the fund, and it should be subject to the federal debt limit.

Jefferson, Lincoln, FDR and Eisenhower proved that public investment can generate vast returns. The federal budget should be a tool to encourage such national

investment instead of writing it off. As you may know, Mr. Chairman, Senator Warren Rudman and I co-chair a commission at the Center for Strategic and International Studies that has been working with members of the House and Senate from both parties on these ideas in which Senators Dodd and Hagel are heavily involved. We are hopeful that we will see some movement in this Congress.

Mr. Chairman, all of us who believe in the importance of public sector investment appreciate your leadership here. Our elected representatives can continue in the footsteps of great American leaders by adopting a different perspective of our national wealth and how to increase it—it is an issue that should be debated in this Congress and throughout the country.

Thank you very much. I would be happy to answer any questions that you might have.