SPECIAL PRESENTATION:

"WHERE NOW FOR THE U.S. ECONOMY?
DOMESTIC PUBLIC INVESTMENT, FOREIGN DIRECT INVESTMENT AND AMERICA'S POSITION IN THE WORLD"

INTRODUCTION:

**JOHN PODESTA,
PRESIDENT AND CEO,
CENTER FOR AMERICAN PROGRESS**

FEATURED SPEAKER:

**AMBASSADOR FELIX G. ROHATYN,
PRESIDENT,
ROHATYN ASSOCIATES LLC**

**11:00 AM – 12:00 PM
TUESDAY, SEPTEMBER 22, 2005**

TRANSCRIPT PROVIDED BY
DC TRANSCRIPTION & MEDIA REPURPOSING

MR. JOHN PODESTA: Good morning and welcome. Thank you for being with us today. I am John Podesta. I'm the president of the Center for American Progress and I'd like to welcome you for this discussion, "Where Now for the U.S. Economy? Domestic Public Investment, Foreign Direct Investment, and America's Position in the World." Of course, an entire conference could be dedicated to exploring this topic; however, I'm not sure they would prove any more enlightening than an hour's discussion with our speaker.

The term prescient is not one that applies to very many people in public life, but I think it does apply in the case of Ambassador Felix Rohatyn. It was almost three years ago that Felix pointed out that America now faces two major challenges simultaneously. The first involves our approach to international and national security and dealing with Iraq and the war on terrorism. The second involves our domestic economic and political policies as we face a possible war and a weak economy simultaneously. "Responding to these challenges," he warned, "will require real sacrifice on the part of all Americans. And if sacrifices are to be justified," he said, "they must be fair." Clearly, our nation is now paying a staggering price for our leaders' inability to anticipate these challenges and their unwillingness to answer them. Of course, now in the wake of Katrina and what could be the devastating consequences of Hurricane Rita, the demands we must meet have expanded multifold, making the necessity of a progressive national strategy for growth and security even more urgent.

And who is there better to help craft that strategy than Felix Rohatyn? Many Americans know him best as the legendary Wall Street investment banker who saved New York City from bankruptcy, but Felix is also a true internationalist with a keen understanding of the complexities of the global economy. That's why in 1997 President Clinton appointed him as the United States ambassador to France, a post that he held until December, 2000. Over the course of his career, Felix Rohatyn has served as a member of the board of governors of the New York Stock Exchange and currently serves on the board of directors of several major firms in the U.S. and Europe. He is a trustee of the Center for Strategic and International Studies and a member of the Council on Foreign Relations. He's a veteran of the United States Army, and he holds a bachelor's degree in physics. We are honored to have him with us today. Please join me in welcoming Ambassador Felix Rohatyn.
(Applause.)

AMBASSADOR FELIX ROHATYN: Thank you. Thank you. It's a great pleasure to be here in a time which is very difficult for everybody. A few months ago, John asked me to give a talk about the shortcomings of American infrastructure. This is something I've been doing now for about 20 years, with consistent results. (Laughter.) And I think nothing would have changed if it hadn't been for Katrina. Then, of course, now we've had a crisis so now people are paying attention to infrastructure. Whether ultimately they will do something about it is another question, or how they will do it, and that's really one of the subjects I wanted to discuss a little bit. I have argued for years now that we needed some type of a development bank, some type of a national infrastructure bank. This is always greeted by questions about the budget and the deficit, but I think Katrina has restructured not only New Orleans, but the way people think about public investment now. And I think it's for the wrong reasons, but it does give us an opportunity to maybe move this a little bit.

We've had any number of proposals as a result of Katrina. We've had President Bush. We've had experts. We've had people from all walks of life giving advice, and I can't – I am not an expert on New Orleans, but I have gone through the crisis of a big city – New York – when it was almost bankrupt, and so I have some knowledge of how you have to prepare the relationship of a city with a state and the federal government if the city is incapable of dealing with its own affairs, which is what the case will be of New Orleans.

As of now, the city of New Orleans and the state of Louisiana are wards of the federal government. The expenditure of money, the signing of contracts, the extension of credit – these and many other things will require federal approval in one form or another.
New political and financial structures will be required to recognize this situation. They require difficult negotiations, but the political realities will require that home rule be significantly impaired. I learned that 30 years ago when New York City became a ward of the state and the state itself had a very close brush with bankruptcy. Unless a clear line of authority is established quickly between the White House, the governor's mansion, and city hall, the internal quarrels and competition between levels of government will consume disproportionate amounts of time and effort, will be very destructive, and will waste a huge amount of money. We learned that in New York City 30 years ago. New York State took control of the city through two state agencies. The first was the Emergency Financial Control Board, which included the governor and the mayor and developed a five-year plan to bring the city back to life. Secondly, the Municipal Assistance Corporation, with a board of private citizens, provided financing to the city by selling long-term bonds as part of the five-year plan, backed by state tax revenues.
The federal government provided seasonal loans and the municipal unions and the city's banks committed themselves to investments in city bonds. Combined with significant reductions in the city's expenses and temporary tax increases, this plan, coupled with new capital investments in the city infrastructure and with a recovering economy, brought the city back to balance by 1981.

The plan succeeded because we had outstanding political leadership from both parties. Governor Hugh Carey, a Democrat, and Senator Warren Anderson, a Republican, had one objective, which was to keep the city solvent. They were a great team and Ed Koch was elected mayor in 1997 and added his strength to the political effort to save the city. And I want to say that it is – without real political leadership, it is impossible to deal with one of these things. The business leaders and the labor leaders from the city and the state understood the crisis, and while we had very difficult negotiations with them, they were always there when we needed them. The Ford administration overcame internal conflicts, which kind of remind me of what I read in the papers about what is happening with the Republicans here, and really there was a group in the Ford administration that wanted the city to go bankrupt. That was headed by Treasury Secretary Bill Simon, who felt that a bankruptcy of New York City would be a great example about the harm of liberalism to a large society, and that a bankruptcy of the city would show that.

Cooler minds, and in particular Arthur Burns, prevailed, but actually the people who talked Jerry Ford out of a city bankruptcy were the president of France, Mr. Giscard D'Estaing, and the chancellor of Germany, Mr. Helmut Schmidt. In November of 1975 when the first economic Western summit took place and Jerry Ford went over there with his team, which included Alan Greenspan, Dick Cheney, Don Rumsfeld – these are familiar names – (laughter) – and Arthur Burns asked Giscard and Helmut Schmidt in front of Jerry Ford how they would feel about a New York City bankruptcy, and they both said, you can't be thinking of a thing like that. You know, people would think America is bankrupt. You'd have a worldwide crisis of the dollar. And Jerry Ford came back to Washington and signed the legislation that enabled us to go on.
And actually, when I came to France as ambassador in '97, I went to see Giscard and told him I still thought we had a big debt towards him for what he had done, and I went down to his city to give a speech about his – about what he had done for us.

Now, why is any of this relevant to New Orleans and the Gulf Coast? As a result of Katrina, the revenues of the city of New Orleans and of the state are going to be decimated, and therefore new structures are going to have to be created to control the flow of money, to control the revenues coming from the federal government, and to sell bonds to the public without having much of the money diverted every time you walk through a door. And somebody will have to be the arbiter of the city's financial plan. That's not likely to be the mayor. It's not even likely to be the governor. And similar structures to New York's Financial Control Board and MAC will have to be created.

In addition, it seems to me that a regional structure will have to be created to manage and finance the reconstruction effort in Louisiana, Mississippi, and Alabama. A regional authority along the lines of the TVA should be considered to manage the outflow of the Mississippi, to deal with the levees, and to plan the reconstruction. I have no idea how much all this will cost. I'm just using the figure of $200 billion because I read this in the paper, but assuming that $200 billion is a figure that is reasonable, then I think that that kind of an authority should have one half of its capital, say $100 billion, should be provided by an authorization to issue 50-year bonds over a period of 10 years to the extent of $100 billion; bonds that would be guaranteed by the federal government. And the other half should come by a pledge of new revenues from the federal budget over a multiyear period, which should come from either new taxes or offsets or a combination of both.

I think it is hard for me to imagine any of this happening without some kind of taxes, whether it's a rollback on the tax cuts that have been voted or new taxes, in addition to cutting back on expenses of some of these greater projects like this bridge to no place that is part of the last transportation bill. That new authority – that new regional authority should have a very strong chief executive officer appointed by the president with the consent of the Senate, and an independent board of directors, and complete transparency as to its accounting. I think that is an absolute necessity. And the other thing that I believe in, because we did it in New York, is to have the public know that there is an attempt at fairness in the way all of this happens. I mean, this plan of recovery isn't going to be fun and games. It isn't going to be pleasant. There's going to be a lot of sacrifice to go around in this and there has to be a consciousness that this is done with some – at least some interest being paid to the issue of fairness. We did it in New York when we deferred wage increases, when we put in tuition at the city university for the first time. We took into account people's incomes, whether they were poor or whether they could afford it, et cetera. And if you don't do this – if you don't do it, people won't follow you and nothing will happen.

Now, there is another issue here that's kind of interested me for some time, which is the issue of accounting. Under accounting – under normal business accounting principles, the investment of $200 billion in the reconstruction of the region should be treated as an asset. Under government accounting, it is treated as a liability and it has negative impacts on the financial markets. And it may be that the magnitude of the reconstruction effort and President Bush's statement of "We will spend whatever we have to," which is probably the realistic description of this effort, will finally allow of the creation of a capital budget for the federal government. There is a fundamental economic difference between investment and spending. The former creates wealth and the latter uses it up. The accounting should reflect the difference. Under the present rules, Jefferson could not have made the Louisiana Purchase because of the deficit. He would have had to go to war as the alternative.

Infrastructure in Europe is financed by long-term bonds issued by the European Investment Bank on behalf of the members of the European Union. That may be one of the reasons Europe has a superb network of high speed rail and in general a level and a quality of infrastructure far superior to ours. Despite pork-laden bills like the recent $284 billion transportation bill, our national infrastructure has been badly neglected over the years. The American Society of Civil Engineers, which grades categories of infrastructure from schools to sewers, indicates a need of $1.6 over five years to bring the national infrastructure up to reasonable standards. That requires increases of $300 billion every other year. And incidentally, the state of our sewers is better than the state of our schools. To help deal with this, I think the Congress should authorize a trust fund or an infrastructure bank to be used to co-finance high priority state and local projects nationwide. No one should be under the illusion that the reconstruction and recovery effort proposed by President Bush will be painless, but it has to happen and I hope that Louisiana and the Gulf Coast will have similar political leadership as we had in New York in the '70s, and as much success in the years to come. That will be a true test of the leadership at each level of government.

Katrina is only the latest in a series of totally open-ended commitments piled on top of one another by the federal government, with no dedicated revenues of any kind to pay for all these deficits. These commitments include Iraq; Katrina; now Rita; the energy deficit, which is 10 million barrels a day – at today's price $700 million a day; entitlements with the new Medicare benefit; trade – $700 billion a year; and our foreign debt, which is now $4 trillion. Now, all of these are totally open-ended. There is nothing set aside or nothing tells us how this is going to get paid for, except printing more money. And sooner or later this is not going to work.

Now, these challenges are also connected to each other. Our budgets deficit increases our debt and reduces the value of the dollar. A lower dollar sooner or later increases the price of imported oil. Higher gasoline prices, like a tax, slow our economy and increase the deficit. So this is just a self-fulfilling and self-increasing spiral and any of these can trigger a financial crisis. The foreign exchange market can start a run on the dollar for speculative reasons or because of a supply interruption. If that does happen, the Federal Reserve may have to raise rates brutally to protect the dollar. That could create a deep recession in the United States at a time when our economy is hugely leveraged. I mean, when you look at the debt that's piled on debt in the private sector of the economy with the hedge funds, the private equity, the banks that are financing everything that you can think about, this country cannot afford a brutal increase in interest rates and a significant recession without having some kind of a financial crisis, which could be very, very, very unpleasant.

Now, what can we do to reduce energy consumption – one of these open-ended issues? And the answer is that we can do a lot of things, but we're not going to do any.
We could tighten mileage requirements on cars and SUVs. We could reduce the speed limit. We could put on an oil import fee. We could have rationing and raise prices. And we could have a huge nuclear energy program.

Now, what are we doing? What we're doing is the governors of the various states are trying to lower the taxes that you put on gasoline in order to make the price cheaper, and this is like saying we're going to make cocaine cheaper so that people use it less. It's unlikely. (Laughter.) Unlikely to happen. So that is – to me, that is the most dangerous thing that I see is this inertia, this unwillingness at every part of the political spectrum to do things that everybody knows have to be done, but everybody says, "Well, it's impossible. It's just totally impossible."

We're never going to be totally independent of foreign energy. That's nonsense. But when Jimmy Carter was president we reduced imports to less than 50 percent of our requirements by having a speed limit, tougher mileage standards, and by doing a lot of other things. And that can be done if a political leader comes along and brings people along. It's not hard. I mean, it's not something that's intellectually difficult; it's just politically difficult.

In terms of finances, the departure of Alan Greenspan comes at a very delicate time in our financial history. Whatever confidence the markets have in the American economy and the American financial structure are heavily dependent on Alan Greenspan's credibility. Even though Alan has been, I thought, more generous than he should have in going along with these tax cuts and these deficits that have resulted, but he is a friend and he is a very frank man and he's been a great chairman of the Fed and his leaving happens at a very awkward moment. His departure at a time when it's clear that the administration is unlikely to reduce the deficit is something also that if there is a supply interruption of energy, if there is some other event in the Middle East that is negative, all of these things can trigger some type of a run on the dollar or financial crisis or something because it's rather easy to start one of these crises. It's not so easy to end it once you're in it.

And when President Bush – when the first thing he said about Katrina is we're not going to raise taxes, it struck me that, (a), that he meant it, but also it struck me that at least he was making clear what is the level – what is his priority, and I would not have put no new taxes as a priority when you have a hurricane that's devastating a city and people who are dying in the Astrodome.

I was in Europe two weeks ago when Katrina was devastating New Orleans and people were on the streets looking at television sets in the stores and somebody came over to me and – because they recognized me from my service there, and they just couldn't believe that this would be happening in the United States – that a country as rich, as powerful, as caring as the United States could tolerate this sort of thing. And this is just one unfortunate reflection of how our position in the world has degraded from being the unquestioned leader – financially, militarily, and morally – to being a big country that kind of scares people and makes them nervous because what we do is not always expected and we certainly don't consult with anybody, or at least we do a little more now than we did up to a year or two ago because we had to – because we can't deal with Iraq by ourselves, because we can't deal with Iran by ourselves, or with North Korea.

But it is a pity, and we shouldn't also denigrate our allies, in particular the Europeans, who are our biggest trade partners, who are our biggest investors, who are our biggest employers, who are our allies. And even though some of them are difficult to deal with, but they're there and I've spoken at – on D-Day at the military cemetery in Normandy a couple of times and there are always 10, 15, 20,000 French people there paying their respects to our dead soldiers, so even though they may disagree violently with us sometimes, it is not because of ingratitude or hostility. It's because they disagree with us. And in some of these cases, lo and behold, they may even have a point. (Laughter.)

So I only have one more point – one more thing I wanted to bring up because I think it's important and I don't think we've paid enough attention. A couple of months ago a Chinese oil company, CNOOC, tried to buy Unocal. And things were going along fairly swimmingly and it was fairly large. Unocal is not a big domestic oil producer and most of their reserves are out in the China Sea anyway, so – but all of a sudden the Congress got involved in this thing and they became so difficult that ultimately the Chinese company withdrew.

Now, we ought to know what it is we want. The Chinese own $600 billion of our

Treasury bonds, which means they could buy 30 Unocals if they felt like it. And we ought to know whether we want them to do this sort of thing. It's not open and shut—the sale of control of an American company to a foreign, government-owned entity. There's some issues to be discussed. But basically if we could turn some of that $600 billion debt into some kind of equity, because I think ultimately the Chinese are going to want to do this sort of thing because clearly owning equity in big American companies is better than owning a Treasury bond that pays 4 percent or so, we ought to have a policy, and that was never discussed. And I think there ought to be some kind of a Chinese-American commission on investment created along the lines of the Gore-Chernomyrdin Commission to begin talking about these things ahead of time so that we don't have a crisis if two days form now it turns out that some Chinese company wants to buy John Deere or something.

And I think not only on these subjects, but on a very broad variety of subjects
China is now a big enough player on the world market and a big factor in our economy so that we ought to have some type of semi-permanent or permanent structure that enables us to talk to them not about Taiwan or about whether they've got missiles aimed, but on day-to-day economic and social issues. Companies are social and political entities in addition to being economic entities.

So that is just a small suggestion that occurred to me, so this is kind of a jumping around on a few things that I've been thinking about and I thank John for inviting me here. I thank you for coming and spending the time, and I'm happy to answer questions if you have any. Thank you. Thank you very much.
(Applause.)

MR. PODESTA: Question in the back? You want to just go ahead?
Q: How do you think the housing bubble is going to be resolved in the U.S.?

AMB. ROHATYN: Noisily. (Laughter.) No, that's a flip answer. I do think that they've gotten way ahead of themselves and credit has been made much too cheap. And as in all of these things, you have various businesses that sort of feed off each other, like appraisals. I mean, when somebody wants a mortgage, you bring in an appraiser. He's not going to put in a low appraisal probably, so you have these pyramids that get created of values that are hard to check because none of this is liquid, and I think it's way out of proportion.

In New York City, I know of a penthouse that just was sold for $38 million, and it's not a huge thing, but it's $38 million. So you have things happening, and that's not where the danger is because the guy who bought this isn't going to default – (laughter) – but the danger is in the sort of middler markets where people are lining up to be able to leave a bid for a co-op or a condo and I think that's pretty dangerous.
Yes, sir?

Q: Let me ask you about the trade deficit. We have record trade deficits. The standard way to get rid of them is to let the dollar slip lower and lower and eventually our

industries are supposed to be competitive. We may be at the point where that doesn't work anymore structurally. If we don't do something about it, there surely will be a lot more reactions like the reaction to the Chinese investment thing – a much more populist politics coming out of the country – and both parties seem wedded to a set of shibboleths that doesn't allow anybody to move until the recession comes, I suppose.
What would you do about the deficits?

AMB. ROHATYN: Well, I wouldn't pretend that increasing the value of the Chinese currency by 2 percent is going to make a huge difference, because it isn't. The answer is, I don't know. I think that China – the impact of China and India – huge countries where the differential in income is so enormous – isn't going to respond to a simple currency move unless we want to devalue the dollar by 50 percent or something. And that we're going – we're slipping not so much because of the overvaluation of the currency, but because ultimately you're going to have hundreds of millions of people that are much better educated than we are, both technically and in terms of literacy, in terms of general education – so that is a long – that is a whole different issue than simply fiddling around with the currency. That's an issue of differentials in standards of living, things that are going to be long term. I don't know what the answer is because I think ultimately there won't be much movement and we will resort to some kind of protectionism and fairly radical policies.
Yes, sir?

Q: Could you expand on your intriguing comment about converting some of that $600 billion of debt? Is there some way we could just use that to get investment in high speed rail…?

AMB. ROHATYN: Well, I was just saying if China uses, say, $30 billion and in lieu of a government bond buys an American company, they're turning that into equity.
Now, can we get them to finance our high speed rail? I suppose we could if we wanted to. That's why I thought if we have some kind of a dialogue with the Chinese on a continued basis on economic issues that are both public and private, that it's something worth doing.
Yes, sir?

Q: In economics I learned, the developed country was supposed to have the financial surpluses and loan it to the less developed country – (laughter) – and we have the reverse going on, so I – I mean, it doesn't seem to me it's really a sound policy that they would convert their Treasury bonds into taking over all our companies. I mean, there's a fundamental imbalance here is that they're using an export-growth strategy and with a country as big as China or India carrying that out, can the rest of the world really manage that?

AMB. ROHATYN: Well, I didn't say I think this is the best kind of thing for us, to have this position of being indebted and living off the credit of the rest of the world – essentially the Chinese and the Japanese being the biggest factors. But looking at

individual events, I can see that in some cases it might be beneficial to have some of that debt converted into permanent investment – permanent direct investment.
I mean, credit – people forget also that credit is not a science; it comes from the Latin "to believe" – (laughter) – and one of these days this is going to be a real stretch if we keep doing what we're doing.

Q: Right, so these two countries have 700 million people (off mike) making a dollar a day and they're doing export-led growth. I don't really see why we should encourage that strategy.

AMB. ROHATYN: Because they finance us.

Q: But is that sustainable?

AMB. ROHATYN: None of this is sustainable I don't –
Yes, sir?

Q: You mentioned several open-ended deficits, each one of which could trigger a recession. What's the cumulative probability of us – of the economy taking a big nosedive?

AMB. ROHATYN: I can't tell you. The reason I mention these deficits together is that I think they're rarely looked at together. I mean, by and large we look at one thing. We have a problem with entitlements. We have a problem with energy. We have a problem in Iraq. We have Katrina. But we don't usually think, well, you know, so what happens if we add the next one to this list? And I don't know what the answer is, but I do know that this is not a riskless exercise that we're involved in.
Yes, sir?

Q: Yeah, as someone who has known your work since New York, I just wanted to assure you your message on public investment is always welcome, at least in some quarters. The American labor movement is with you on this. But you mentioned the changes in circumstances between now and then and many of them economic circumstances, but one of them is the political deficit. We've got one group, as you've observed, in Washington who believes the first response is we can't raise taxes to respond to this opportunity and this desperate need. But we've got another group of people here in Washington who believe that whatever we do we've got to balance the budget as a way – and it seems to me that's a fairly serious constraint on the opportunities that exist to respond to the needs in Katrina, but also to launch a larger public investment agenda in the country. And I wonder what your counsel to that group of people would be about how to be fiscally responsible as well as to respond as we should to the desperate needs of Katrina.

AMB. ROHATYN: I am very sympathetic to that view. I certainly believe that one should live within one's means, but I'm not religious about the need to have a balance budget day in and day out, which is one of the reasons why I'm pushing the notion of a capital budget because that gives you a little bit more flexibility with respect to how you

handle your accounts. In fact, I think it's a necessity. I think the – you don't have a real picture of the financial situation of this country if you treat investments as if they were expenditures, so I do think that the balanced budget is a definition that doesn't really tell the story. And as I said, I mean, if Jefferson had had to go to war because of the accounting of how you handle the Louisiana Purchase that would be kind of silly. What – so, but I think that requires a certain level of education, which is technical also, which is difficult. And I've tried it and I know how difficult it is.
Ted?

Q: Ambassador, I've been a little bit surprised to hear the rising voices around the country and even inside the beltway here about who should share in the burden of rebuilding New Orleans and the Gulf region. Could you, from a philosophical point of view, talk about why think, in fact, it's a shared burden and not just – it should not just be relegated to the people in that region with the private sector in just that region. Why should all Americans help or take on this particular problem of paying for the reconstruction?

AMB. ROHATYN: Because they're all Americans. I think when you have a disaster – you know, it's one thing if a city goes bankrupt because its profligate or it doesn't know how to handle its affairs, et cetera, but if you have a national disaster or a terrorist act, I think that's perfectly normal to share that. I think the question is how do you share it and who pays the most and how do they deal with it? But the philosophy that everybody shares, I have no problem with it. One last question. Yes, ma'am?

Q: What would be the focus of your efforts today given the United States' reliance on trucking and indirectly, therefore, on low oil prices as a large country with an expansive network of highways.

AMB. ROHATYN: Well, I think that infrastructure across the board can improve the productivity of the private sector, which includes trucking. In fact, now I saw a couple of governors who are bonding intellectual property. One was the governor of Michigan, who wants to improve the efficiently of the automobile industry, and another is California and stem cell research. So I believe that across the board, infrastructure can be used as a way to improve the productivity of the American economy.
Thank you. Thank you very much.
(Applause.)

MR. PODESTA: Well, I want to thank the Ambassador for (audio break) we toured the world with some very provocative thoughts, but putting down some very concrete ideas that I think, as the Center, we will try to share with our friends on Capitol Hill because I think that they're deep in the discussion, particularly on this question of the structures of how this money's going to go out, and I think if we look to the past couple of years to the way money went out the door we should all be concerned as taxpayers as well as citizens and so I think that, Felix, I appreciate your putting, again, those concrete ideas on the table and we'll try to share them with everyone.

Thank you for coming and we'll see you at our next event.
(Applause.)

(END)