

Alan Hevesi:

David, thank you very much. Hi everybody. The entire left-wing intelligentsia seems to be in this room here. Except for me of course. I represent the centrist view on financial matters and I am, of course, an elected official who is above politics.

Can I start with a story? I reprised this story at the Conference of Mayors, I think, and thinking of the character of the people in the audience this old story popped into my head. It is sort of pertinent – it lends itself to a theme – but it is also a good story.

It is about political power. Josef Stalin had to defeat a number of other prominent Soviet communists in the struggle for power to succeed Lenin. He ultimately did. His major rival, of course, was Leon Trotsky. He drove Trotsky into exile and Trotsky was forced to live in Mexico City, and then Stalin had him murdered with a pickaxe to seal the deal. But according to the story, Stalin was not satisfied with the political victory. That was an assertion of power and muscle and strength. He really wanted recognition from the Trotskyites and from Trotsky himself that Stalin's version, ideologically, of the revolution was the correct version. He wanted ideological recognition.

He never got it and was frustrated until one day, finally, he received from Trotsky in Mexico City a telegram. He was so elated after reading the telegram that he called a meeting of the Presidium, all members, and said, "Finally we've got this recognition. I've gotten a telegram from Trotsky. Here's the telegram, let me read it to you":

Dear Joe,

You were right. I was wrong. You are the greatest revolutionary of all time.
Excuse Me.

Leon Trotsky

Everyone applauded – it was a great recognition – except one man in the back, Litvanov. Litvanov didn't applaud. And Stalin said, "Litvanov, why are you not joining in this celebration?"

He said, "Well, Joe, I don't want to burst your bubble, but you know I'm Jewish, and Trotsky is Jewish, and you're not reading the telegram correctly. Let me read it to you."

Dear Joe,

*You were right? I was wrong? You are the greatest revolutionary of all time?
Excuse Me!*

Leon Trotsky

So the rest of my presentation will all be downhill. Thank you very much. The thing of that, of course, is that not everything is as it seems. What David Jones asked me to talk about wasn't so precisely about the character of the block grants. Block grants as a recommendation are a symptom of a larger strategy that I think Mr. Greenstein is talking about. Here is my take as an elected official, politician, now Comptroller.

By the way, running an agency I kid around about being above politics. We are a weak agency if we are involved in partisan politics. The reverse is that as an agency managing a huge pension fund system, involved in policy issues and commenting on the budget we have to be totally non-partisan. A Comptroller's office has to be absolutely professional and expert. What I want, by the way, coming from my perspective – I was a partisan Democrat – Is that Liz Krueger? Hi Liz. Speaking of nonpolitical, nonpartisan people.

I was a Democratic floor leader in the most partisan legislature in America, except for Massachusetts. What I want as a Comptroller, and contextually this is important, is that the people who fight with us or disagree with us will fear us. Not because we can punish them or break their knees or fire them, but because they'll know they're wrong and we're right. In other words, you fight with us, you disagree, you have to know 99 percent we're right because we've done the numbers meticulously. We haven't spun it. We haven't taken a piece for our argument. We call it absolutely straight. One of my most glorious moments as City Comptroller – and this is sort of rambling until I get to my point – was a budget analysis which in paragraph one denounced Rudy Giuliani's budget proposal and in paragraph two denounced the Democratic City Council's response as both being off-the-wall and false and the projections were wrong.

Anyway, here is my take and my assignment. I think there is a strategy (call it a conspiracy – I guess a conspiracy is a strategy that's not yet publicly recognized) by the Bush Administration to dramatically reduce the size of government. I think that is now a conscious motivation by what are called conservative Republicans now that used to be called the Radical Right. The conservatives are now the centrists. I think it's a strategy.

Here's the deal. There is now, it has been passed into law, a \$350 billion tax cut. The program of tax cuts includes dividend tax cuts and personal income tax cuts, on top of prior tax cuts. Tax cut is the religion. It's the religion of this administration. First of all let me comment that the \$350 billion is a phony. Nobody believes it. It is legally \$350 because they put into the law these sunsets. Different pieces of the tax cut program sunset as nearly as 2005. But there isn't a person in America who knows anything about anything who believes that those sunsets will be repealed, and that the tax cuts will not be made permanent.

Operating under that presumption – because that is what the President really wants over 10 years that is an \$800 billion tax cut, not a \$350 billion tax cut. The President originally had asked \$770 billion, I think, and then a reduction to \$550. Then a couple of Republicans in the Senate said this is too much and they dropped it to \$350, and then they did it with a wink and a nod. The President lost from \$770 to \$350 and then signed the \$350 in 20 seconds with great joy and glee. I think we're being snookered a little bit. That's observation number one.

Number two: forgetting the strategy, what is the impact of this? I ran for this job I have as State Comptroller and would kid around with audiences telling them that I had the solution to New York State's problems. I have the answer. It is a proven answer. Want to hear my answer? You elect me Comptroller for four years. You give me the authority to borrow \$50 billion. I'll borrow \$50 billion and for four years it'll be great. We'll have the cash to fill every pothole, to give everybody a raise, to provide assistance to every social program. Every advocate will be happy. (By the way, advocates all ask for money when we have money. Then ask for money when we don't have money. That is the role of an advocate. That is what we do.) And it will be great. At the end of four years I'll go fishing in the Florida Keys and somebody else can pay off the \$50 billion, but for four years, I guarantee you life will be good.

How do I know it works? Because the federal government did that, particularly in the 1980's. Somebody told me, Bob, that you had some fond remembrance about the Reagan Administration. Here's my take on it. They did exactly that but it wasn't billions. It was trillions in the 1980's. The national debt in 1980 – the day Jimmy Carter left office and Ronald Reagan was sworn in, and they released the hostages in Iran – the national debt was \$900 billion. In 1992, twelve years later Reagan, Bush and Democratic Congresses, the national debt was \$4 trillion \$300 billion. In other words, in 12 years we borrowed \$3.4 trillion. That is an average of about \$280 billion a year. What does that mean? What is the impact?

Two positive consequences, if you are Ronald Reagan. One is, when you borrow all that huge, vast amount of money, that means a lot of cash at the beginning of your operation and so you can do two things. One is get reelected. Nothing like having a lot of borrowed cash, or any other kind of cash, when you're running for office. Election years are the politics of yes. "Yes. Certainly. Of course. Yes. Sure. Yes. Yes." And two, he spent most of it on the military. Remember the \$700 toilet seats and so on? Also weapon systems, on technology, on professionalizing and so on...the most powerful military on earth started then and the Soviet Union tried to compete and collapsed. Part of the collapse of the Soviet Union was their economy couldn't sustain both their military international involvements and their consumer economy. That is a positive from the point of view of Ronald Reagan.

The reality is, of course, after you get past 1984, 1985, 1986, you have to repay that debt. When you repay the debt, it has a couple of consequences. One is all that vast amount of money – the trillion dollars in borrowing – triggers two things: one, there isn't a lot of money left for private enterprise to go into expansion, to advance inventory, to do research and development. What there is available is an enormously higher interest rate because the law of supply and demand works: the interest rates go up dramatically. If you have very high interest rates, that is a dampening on activity. It's not just high interest for the repayment of the debt. The government has to repay the debt, but it affects your credit card, your mortgages, you're buying washing machines, televisions, and so on. It has a terrible long-term negative effect.

When I was a young Democrat growing up, I used to hear conservative Republicans railing about the debt, the debt, the debt. I was testifying in the Ways and Means Committee in the Congress about this. I was arguing against reducing the dividend tax to zero because the first impact, by the way, may have some long-term stimulus effect and more people may go into the stock market because the tax has been reduced to zero. But the truth is people have dropped out of

investing in the stock market not because of tax considerations, but first of all, the 1990's Internet bubble when the market collapsed, people were investing in Internet companies that promised to connect communications to Mars but hadn't yet rented offices anyplace. People were buying their stock because of that kind of euphoria. Then it collapsed.

The second piece of it, and it is therapeutic for me to do this, is corporate corruption. The scandals – Tyco, Adelphia, WorldCom, Enron, and AOL/Time Warner – one after another has conveyed a message to all those Americans who were in the market for five years to drop out. That's had a devastating effect on the financial services industry. It affects America. It affects New York particularly. That is our home-based industry. So even the dividend tax is not going to have that simulative effect that we're hearing from the White House because of these other variables. Meanwhile, since the state is coupled to the federal government, it is very difficult to uncouple. Their tax policy is our tax policy. Their income tax rules are our income tax rules, essentially. Therefore, the State of New York will add to its deficit the first year (if they reduced to zero, which they have not) \$526 million to the deficit. We loose that income.

So I was testifying there and there was a Mr. McGreevey there from Louisiana. I have a lot of fun when I know I'm getting on a plane and fleeing. "So Mr. Hevesi, you think it's better that the government decide how to spend America's money rather than the families of America?" I said, "I've heard a lot of that, and I don't why you should so viscosly attack President Bush." He said, "What do you mean?" This was just before the war in Iraq. I said, "It's my understanding that the President is about to launch a war in Iraq and spend hundreds and hundreds of millions of dollars, and I bet he hasn't called up one American to say, "Would you rather have the money or would you rather have me spend it over in Iraq?"

Now that is me having fun. I don't want to be disingenuous and tell that I see some justification in what happened there but that is another issue for another debate. And I probably don't want to debate in front of this crowd.

The bottom line is the consequence. When was the recession? 1986-87? I attribute that to a great extent to this deficit. This huge, huge debt is a multi-trillion debt that we accumulated. \$280 billion a year. We went into a recession in 1987-ish and New York State, which has its own dysfunctional governance, didn't come out of it until 1993-1994. We lost 600,000 jobs. I don't want to be oversimplifying this. It may have been if New York State had cleaned up its act there might have been 500,000 jobs, but it has a devastating effect. Debt is bad. Debt is easy politically.

The State of New York just passed a budget. There was a big fight. The legislature raised some taxes, including the income tax. The Governor was against "job killing taxes." Know what a job killing tax is? It's a tax that Governor Pataki opposes. But the taxes he supports – increases – they are not job killing. In the same budget, he had proposed \$1.4 billion in new taxes. Did you know that? Over here they debated restoring money for schools, restoring money for health care, and he did partially with the new surcharge on the income tax and a piece of the sales tax. But over here was a recommendation in the Governor's budget of a \$1.4 billion in increased sales tax on clothing, tires, fishing license fees, and so on.

The worst for me, although politically this is the easiest, is that in the state budget (which is a reflection of the problem that Mr. Greenstein was telling you every state has) there was a \$12 billion deficit. We're not curing that deficit. What we're doing is rolling it over with \$5.2 billion in one-shots that will not recur; \$4.2 billion of which is borrowing.

You've read about this – this is the tobacco bond borrowing. We get money from the tobacco companies, part of a litigation, an agreement. Every state gets compensation for cigarette related emphysema, lung cancer, heart disease, and so on. Our share of it is between \$400-\$500 million revenue coming in every year now. The deal is done. Those revenues are supposed to go health programs. What the Governor proposed, and had been adopted, is a borrowing of \$4.2 billion, taking all or most of the revenues over a 12-year period (12-year bonds). That is \$4.2 billion of capital borrowing to pay operating expenses.

This violates the first commandment of financial management: thou shall not use capital money for operating expenses. New York City did that, by the way, very extensively in 1975 and we nearly went bankrupt. I use the word 'nearly' to be politically correct only. The reality then is that next year, the \$4.2 billion is gone because it closed this year's budget gap. The \$4.2 billion it paid for was not one-shot expenditures; they're recurring, so they'll be back – they have to be paid for somehow. On top of that we will have to find \$6.5 billion out of the tobacco revenues to pay off the \$4.2. This is not a smart way to do governance, except it is easy politically because you can push it off into the next year. The big debate was only about a third of the budget. This is what we're headed for. There is no comfort in New York State that our \$12 billion deficit doesn't compare to California which is a \$35 billion deficit. It's mind-boggling. \$2 billion was a serious deficit, but we could manage it. \$5 billion was a catastrophe; we're doing \$12 billion now. It's incredible.

Here is the federal government saying tax cut, tax cut, tax cut. The other piece of that, of course, is who gets the cut? A millionaire will average a \$93,000 tax cut. I don't know what the stimulus in the economy is going to be. I don't know what that millionaire will buy that he couldn't afford to buy before he saved \$93,000. If you're doing a tax cut, at least the less-wealthy people have to go out and buy things.

I have a new theory. This is completely unscientific. It will get me in big trouble. Every millionaire gets a \$93,000 check – the benefit from the taxes – and then writes a \$100,000 check to the reelection campaign of the President of the United States, so it is a government subsidy for campaign contributions. You're not laughing at that one? In this crowd, you take that seriously! Whoever is writing notes, I'm just kidding. I don't know if that is true. But I'm suspicious.

This is just bad, bad governance. The bottom line is that it is an ideological world view that Bush Administration's responsibility is to pour more money back into the hands of the wealthiest Americans with a little dribble here and there for middle income and lower income people that has no meaning economically. It puts us into enormous debt.

Let me make this final observation. \$280 billion deficits that averaged in the 1980's to get us to \$4.3 trillion in debt; this year's deficit is \$500 billion already, even with inflation. It was \$240 billion before there was a calculation of the cost of the war in Iraq and before they calculated the

cost of the tax cuts. So we're going to be \$500 billion. You can do that in a crisis, in an emergency, for a year or two to get over a hump. But this is going to go on for decade. If it goes on for a decade it destroys the ability of the government of the United States to participate in social programs, to add money for aid to the elderly, etc. I don't know how they financed the prescription drug, but you get the idea. I think part of that is that for some of the people in the Senate and the White House, it is ideological. This is what they want to accomplish. Get that money out of here. Get it back to the wealthiest firms. That is what America is – free competition – the wealthier you are, the more virtuous you are – the old ethic. I'm overstating this out of some anger, but the bottom line is that it is terribly destructive.

What is a block grant? It's another device to shift responsibility away from the federal government to the states. There was not a calculation with the welfare block grants when they passed the Welfare Act. There were going to be block grants to the states, giving states discretion. No one anticipated at the time that legislation was passed that there would be this dramatic reduction in the number of people on welfare. The law had that affect and some harsh administration had that affect, but that led to a surplus. The block grants provided a surplus and many states used that surplus just to close some deficits. When you're block-granting Medicaid where the volume goes up, the bottom line is that the block grant would be fixed. It means that the next year the same amount of money will be even less than what you need because of inflation and because more people will need the social service, particularly during a recession. Block grants are just simply an attempt to get out from under these costs and to follow that ideological worldview that the government should be solely committed to policing, to military, to foreign policy, and to do very little else in terms of social services. That's what we're facing.

I think it's correct that this could be, if it is packaged right as a message, a real powerful campaign argument for those who disagree, for Democrats. This is the issue.

Here is another provocative statement. May I? Think about this although you won't be provoked so much, but my conservative banker friends don't like to hear this. We had in the 1990's the greatest boom in American history, and it did filter down to the states. New York City and New York State each had \$3 billion surpluses in the best years, after saying yes to everybody, there were still surpluses. It was great. I was a genius. Our pension funds were actuarially supposed to grow. They didn't have 8¾ percent; they were growing at 18 percent, 20 percent, 24 percent - I was great. I was a genius. All pension fund managers were. It was wonderful and extraordinary. You know when that boom started? Chronologically, you can't argue these facts. It started the day that Al Gore as Vice President cast the tie-breaking vote in the U.S. Senate for a massive tax increase. An increase that only Democrats voted for in the Senate, and it ended effectively on or about the day that George Bush sent us those first \$300 checks a year and half ago.

This is really counter-intuitive, but it's not. You know why not? I'm not recommending increased taxes always has a virtuous result – it does not. You increase business taxes and they pack up and leave. In an age of mobility and technology, that is bad when we lose jobs. New York has been doing that. You have to be very careful and sensitive how you do these. What Reuben said, the Secretary of the Treasury, and what Bill Clinton said was, 'We're going to be damn serious about this enormous debt and these deficits because they are killing us. They don't

give us room to be able to provide help for our people. So we're going to bite the bullet politically.' And it cost them terribly. After they did this came Newt Gingrich and the majority in Congress as a direct correlation. But they closed the deficits and we ended up with multi-trillion surpluses.

The message to the business community was that we're going to free up resources, we're going to encourage you to grow. Go expand in a time of technological change. The 1990's there was enormous technological change. Go expand; go invest in R&D; go rebuild your inventories and we had this incredible boom. I believe psychologically when President Bush took office with his religion of tax cuts he was saying to the business community, we were kidding. We weren't serious. We don't care about the deficits. We don't care about the long-term. We care about winning the next election, which is what tax cuts do for you. With other variables we now have a constriction of activity.

So I think these tax cuts are wrong. I don't think there was a great clamor for them. I don't think every multi-millionaire in America was demanding tax cuts. They like them because it is always good to have money in your pocket. I think they are going to be very damaging to your agenda, to our agenda, to provide minimal services for people, to fix our schools, and to provide help to states.

Every state is in huge trouble. Fifty-seven counties in the State of New York out of 62 have raised the property tax. Ten have raised sales taxes and another 35 have asked for permission because they are at their legal cap. I had to write a report two weeks ago with 25 of my staff people because Buffalo is bankrupt. We're putting in a financial control board in Buffalo, and this is happening all over America.

So this is a huge fight coming up on the political level to make this case in a much more simpler way than my rambling has done here. You want to have a simple message. These are tax cuts for the rich that are going to be very damaging to America because they are going to put us in such enormous debt we will not be able to meet the needs of our people.

Let me stop there. I'm sorry this is not an optimistic message but I think it is the real message. I thank you for allowing me to participate.