

IS IT TIME FOR A NEW DEAL?

By Pat Regnier

Americans are prosperous, but worried—about jobs, health care, retirement. Now some in Washington are asking if life really needs to be this risky.

So how are you doing? Money-wise, that is.

One way to answer this is to take a look around your house. There's a flat-panel TV in the family room, an MP3 player docked to your computer and a tangled mess of cell-phone chargers over by the kitchen counter. You have more clothes in your closets than you can wear. (Crazy how cheap a T-shirt is these days, isn't it?) Those closets, by the way, are surrounded by a house that's bigger than the one you grew up in and is worth maybe twice what you paid for it. Out in the driveway on the car you bought with 6% financing, perhaps there's a window sticker bearing the name of your kid's university. Life looks abundant.

Then again, maybe you answer by opening up that desk drawer in your bedroom. The one with all the bills and paperwork you slog through the first Sunday of the month. Six years after the market crash, your 401(k) statement says you've gotten back to even and then some, but you wonder how you'll have enough to



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retire without a pension like your dad's. There are a few credit-card bills too, and you won't pay all of them in full. If you do have a kid in college, tuition is up \$1,200 or so this year. Then there are bills for treatments your health insurance doesn't fully cover; at these prices, you wonder how you'd manage if you got laid off and had to buy your own coverage.

Or perhaps you have a cushion: Your spouse also has a job with insurance. But somehow having two incomes doesn't put your mind at ease. Now your family has twice as many jobs to lose, and you suspect that you'd be able to maintain your standard of living for, oh, 20 minutes if one of you got fired. Like that nice, competent guy who used to sit down the hall from you just did.

The high-tech, free-trading, wildly productive New Economy is showing its other face. Call it the Anxiety Economy. By most of the obvious measures—GDP growth, unemployment, inflation—things are good. But wages have been growing very slowly of late, and middle-class and even upper-middle-class Americans are reminded every day that their families are just a bad break or two away from a financial crisis. More people are getting angry: The November elections heralded the arrival of a new voter bloc, the "Lou Dobbs Democrats," who blame cheap foreign labor and immigration for anxiety about our jobs. According to Republican pollster Frank Luntz, anxiety abides, even if you don't feel personally threatened. "People think they are doing okay," says Luntz, "but that everyone else is badly off."

As the new Congress takes over, for the first time in 12 years Democratic legislators have a chance to set the agenda, and the Anxiety Economy is going to be near the top. George W. Bush's entrepreneurial, it's-your-money Ownership Society is out. What's in: addressing risk. Some Democrats, like Senators Byron Dorgan of North Dakota and Sherrod Brown of Ohio, focus on the risk that your job will be shipped overseas. Others are searching for a new New Deal between business and the rest of us, keeping foreign trade flowing (with some caveats on labor and environmental standards) in exchange for new public policies that address increasingly risky propositions, from financing retirement to paying for college to the Big Kahuna: health insurance.

There are plenty of ideas for fixes—though some are directly opposed to one another and many will cost you as a taxpayer. First, let's look at just why it is that we're all so nervous. Many conservatives question, with some justice, whether the economy is really as harsh on ordinary Americans as the Democrats say. What neither side disputes, however, is this: The rules of middle-class life are changing.

Um, is that a sword over your head?

Yes, and it's an awfully sharp one, Democrats argue. "Over the past 10 years, we've had something wonderful happen, which is

NEW DEAL: Employer-funded health insurance

NEW NEW DEAL: Universal coverage regardless of job status

huge productivity gains in the economy," says Gene Sperling, former economic adviser to President Bill Clinton, chatting in his cluttered office at the Council on Foreign Relations in D.C. "But if you compare the first five years with the second five years, it's a tale of two cities." In the first half, the economy grew so hot that employers had to hire like crazy, which meant rising wages for

Americans in the middle. Then real wages stalled for several years, even though workers' output and corporate profits kept rising. You'll no doubt notice that Sperling's timeline is suspiciously flattering of Democrats (though Clinton's embrace of free trade still infuriates the party's left). Still, there are reasons for anxiety that liberals just aren't making up.

> You face more competition.

A quarter-century ago, blue-collar workers got a nasty shock when they found themselves going head to head with manufacturers in Japan and South Korea. But that's nothing compared with the scale and pace of what's coming. "Japan and South Korea are 3% of the global labor force," says Sperling.

"China and India make up 40%. There is no precedent for this huge group of

workers that through information technology can compete with American workers overnight."

Those new hands aren't all going to be set to building cars and toasters. They'll be engaged in what economists call "tradable services," which include any job that doesn't need to be done in person. New technology will expose more and more jobs, says Princeton economist and former Federal Reserve vice chairman Alan Blinder. "I can imagine down the road the technology will be good enough," says Blinder, "that on the stage where I lecture at Princeton there could be a hologram of a professor in India delivering the lecture for a tenth of my pay."

> Your income is less reliable.

Jacob Hacker, a Yale political scientist and author of the book *The Great Risk Shift*, dug into the data from a long-running survey that tracks the year-to-year income of thousands of





NEW DEAL: Unemployment benefits for temporary layoffs
NEW NEW DEAL: Wage insurance for disappearing jobs

families and found that more are taking big hits. In 1970 the average American had a 7% chance of experiencing a 50% drop in family income; by 2002 it was a 17% chance. There's more going on here than offshoring—such as jobs being supplanted by technology, the rise of two-income families and divorce, and the decline of unions. Whatever the reasons, the results are scary: The child poverty rate is about 20% in any given year, but more than half of American children will fall below the poverty line for at least one year, Hacker notes. These, remember, are the kids we'll all be counting on to keep the economy humming in a more competitive world. Moreover, as job competition rises for college grads, so does income volatility. A 2005 study by economist Henry Farber, also of Princeton, found that the average college-educated person who loses a job earns 14% less on the next job. "Middle-class Americans are facing much greater risks than they once were," says Hacker.

➤ **Your employer is rolling up the safety net.**

Look at what's happened to what Hacker calls "our private welfare system." Today, 19% of workers with a retirement plan have all of it in a traditional pension, according to research from Boston College. Twenty years ago, that figure was 62%. Instead, most of us with employer-sponsored plans have 401(k)s or something similar. We bear the burden of making sure to contribute enough and the risk of deciding where to invest. And when we leave the company, our relationship is mostly over; it's our job to make the money we've saved last. Meanwhile, companies are less likely to offer health benefits for retirees and are pushing workers they do insure to share more of the burden. The 47 million uninsured include 22 million with full-time jobs.

But you can handle this, can't you?

The odds are certainly in your favor, say conservative economists and academics. Yes, a dynamic, growing economy will

have winners and losers.

And many conservatives concede that the Owner-

ship Society rhetoric has fallen flat. "It's not like it's led to a lot of successes," says Kevin Hassett of the American Enterprise Institute, noting the lead-balloon performance of Bush's 2005 Social Security plan. But they also point to low unemployment and the recent jump in average wages (up 2.8% after inflation in the past year) as evidence that economic growth is helping the middle class. More important, they argue that Americans will prove resilient in the face of change.

First, for all the talk about offshoring, its impact so far isn't what you might think from watching *Lou Dobbs Tonight*. Even Blinder, who believes that offshoring is going to get much bigger, is careful to point out that fewer than a million service sector jobs have moved abroad. The U.S. economy sheds that many jobs, and usually adds more, every two weeks, he notes. And don't forget the other side of the ledger. Trade creates jobs (often indirectly) as well as destroying them.

Moving beyond offshoring, University of Chicago labor economist Steven Davis says there's no evidence that jobs have gotten harder to hang on to over the long run. So why does it seem that way? First, job security has declined for college-educated men, a group that had been relatively insulated from economic ups and downs. Second, says Davis, employment stability actually has fallen at publicly traded firms. They employ just a third of all workers, but news about them gets reported every day. "The sector of the economy that gets the most attention," says Davis, "has become more volatile."

For Brink Lindsey of the free-market Cato Institute, the look-around-your-house test is the one that matters. "Despite a lot of statistical mumbo jumbo from the sky-is-falling crowd," he says, "Americans are enjoying a level of material prosperity unrivaled in the world." In a pugnacious *Wall Street Journal* review of

Hacker's book, Lindsey points out that since the 1970s, the number of college-educated adults has more than doubled, home ownership has risen, and air conditioners, color TVs and dishwashers (most no doubt built in cheap labor markets) have become fairly common even in households living below the poverty line.

What about income volatility? Free-market advocates argue that the way Americans spend suggests that middle- and upper-income households are pretty good at smoothing out the bumps. (Low-income households have a much harder time.) Families can dip into savings—or into their credit accounts. “We have a plastic safety net, and an ability to take out loans on incredibly appreciated homes, and all kinds of mechanisms for dealing with income volatility,” says Lindsey. Of course, using credit cards and home-equity loans to smooth out dips from lost wages is plenty risky, and it only works at all if your income is going to bounce back—something that doesn't happen for lots of laid-off workers.

Easing the Anxiety Economy

Democratic and Republican politicians will be arguing over how rich you are or how shafted you are until at least November 2008. (And afterward they may just switch sides.) Rhetoric aside, it's a fact that many of the tools available to Americans to manage the risk in their lives are seriously outdated, if not obsolete. Employer-sponsored health insurance is a product of World War II-era wage controls; companies could offer it instead of a raise. Traditional pensions have proved too great a burden for many companies fighting overseas competitors, but 401(k)s aren't ready to replace them, and Social Security needs shoring up. Republicans too are warming to the idea that the government can do more to help families cushion economic shocks. “So much of the conservative agenda has become stale,” says Reihan Salam, a writer and political analyst. “How much can you keep talking about tax cutting when the salience of the federal tax burden just isn't what it was?” More important, the Democrats control Congress, and thus the agenda. Here are the three big items they'll want to take on, and how debate over them might play out over the next couple of years:

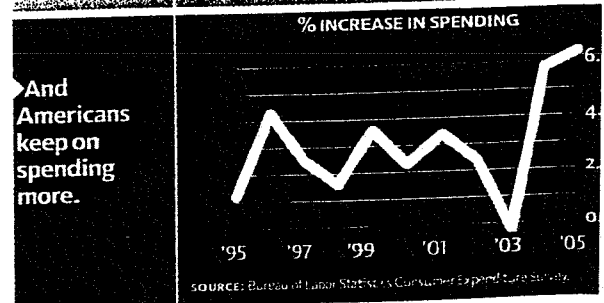
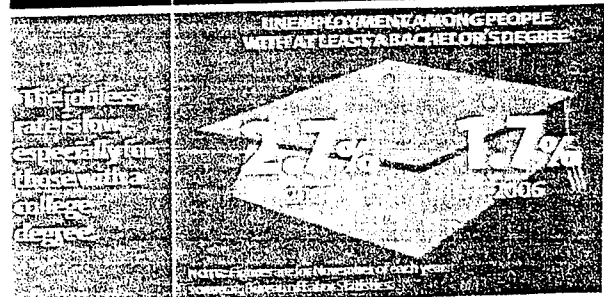
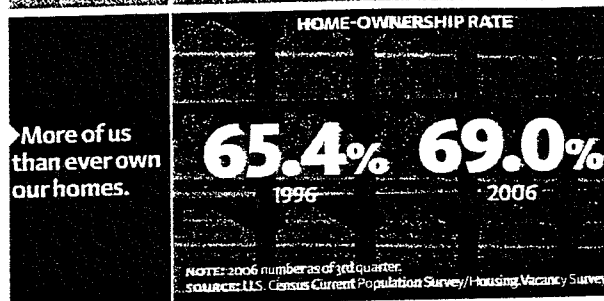
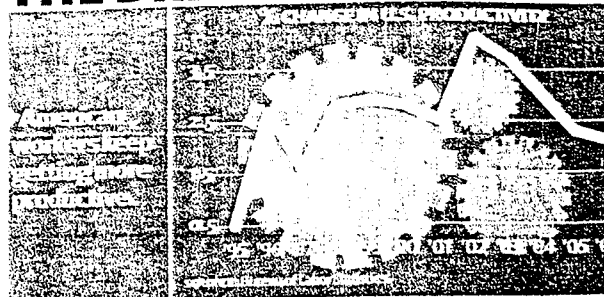
Health Care > Loosen the bond between insurance and your job.

Getting laid off can be doubly devastating: You lose your income and your health insurance. (Unless you can afford COBRA payments even when there's no paycheck coming in.) If we're going to embrace globalization and a flexible economy, leaving the inevitable losers in that process so exposed seems like a bad idea. “If we dealt with health care, some of the people who are skeptical about trade would be less skeptical,” says Barney Frank, the powerful new chairman of the House Financial Services Committee. Democrats have a simple cure: universal insurance. That's “simple” as in easy to understand, not to do. The Clintons, you'll recall, got thumped when they tried this.

1 Economy, 2 Stories

By quite a few measures, the U.S. economy has performed great. By others, there's legitimate cause for worry.

THE DREAM ECONOMY



But the problem looks worse now than it did 15 years ago, so expect to hear new variations on a government health-care solution. Hacker, for one, proposes keeping the private health-care system but requiring employers that don't offer coverage to pay into an expanded Medicare system. In their

THE ANXIETY ECONOMY

CHANCE OF SEEING A 50% DROP
IN FAMILY INCOME

7.2%

1970

16.7%

2002

**Our incomes
have become
more volatile.**

NOTE: Chance for an average person, ages 25 to 61.
SOURCE: Jacob Hacker, Panel Study on Income Dynamics.

AVERAGE ANNUAL PREMIUM COSTS
FOR A FAMILY OF FOUR

TOTAL NUMBER

\$6,438

2000

\$11,480

2006

**Health care
is taking
a bigger bite
out of pay
and family
budgets.**

SOURCE: Kaiser Family Foundation.

INCREASE IN HOURS WORKED
PER FAMILY

MIDDLE
CLASS:

+539

2004

**Families are
having to
work longer
hours.**

UPPER-
MIDDLE
CLASS

+404

2004

SOURCE: Economic Policy Institute.

PERCENTAGE OF HIGH EARNERS AT RISK OF NOT
HAVING ENOUGH MONEY TO RETIRE AT 65

OLDER
BOOMERS

33%

YOUNGER
BOOMERS

35%

GENERATION
X'ERS

42%

**Even some
relatively
affluent
Americans
aren't well
prepared for
retirement.**

NOTE: Top third of earners.
SOURCE: Boston College Center for Retirement Research.

Of course, it would also leave taxpayers on the hook for even more of a rapidly-inflating segment of the American economy. Health-care spending already eats up 16% of GDP in the U.S., far more than in any other developed country. "We don't get good value for the funds we spend on health care," says R. Glenn Hubbard, dean of the Columbia business school and former economic adviser to the President. Liberals think government can push back on costs by negotiating lower fees with drug companies and health-care providers. Republicans would rather see you do the pushing. One of Bush's key health-care initiatives is tax-advantaged health savings accounts to encourage people to pay for more of their care directly instead of through insurance. Hubbard would go further and make all out-of-pocket health spending, including premiums for insurance you buy yourself, tax deductible for those with insurance. If Americans picked up more of the tab themselves, the theory goes, they'd be pickier about costly treatments, and insurance would be more affordable.

But politicians may not be willing to wait to see those theories play out. In 2006, Republican governor Mitt Romney signed off on health-care legislation in Massachusetts. The law provides financial help for people to buy coverage and requires everyone to get insurance, an appealing idea for conservatives who value personal responsibility. The idea is to keep costs down by forcing younger, healthier workers to pay in even if they use less care. It's too soon to say whether Romneycare will work, but California governor Arnold Schwarzenegger, another Republican, is talking about his state guaranteeing insurance for children.

Retirement > Fix Social Security—and get everybody in a private account.

With traditional pensions dying out, middle-class workers will be counting on Social Security more than ever. Charles Rangel, the chairman of the House Ways and Means committee, says he's gotten signals from Republicans that they may be ready to work on a long-term fix for Social Security. What about the private accounts Bush had pushed for? When MONEY asked, Rangel said he hadn't heard the question. (He was kidding.)

Still, if the President wants to expand ownership of financial assets, most Democrats would be happy to create "add on" private accounts that supplement Social Security benefits. After years of complaining about the decline of pensions, liberals have mostly given up on saving them and are instead looking to improve and expand 401(k)s. Sperling, for example, proposes a universal 401(k). Employers could pay in and make matching contributions, but even those with no 401(k) at work could begin saving, and those who switch jobs could keep doing so without interruption. Under Sperling's plan, the government would also offer a match, based on your income, a benefit that might spur employers who don't offer 401(k)s to get with the program. As with Romneycare, this has crossover appeal—it shows that Democrats share some of Republicans' economic optimism and faith in free markets.

book *The Plan*, congressman Rahm Emanuel and Bruce Reed of the moderate Democratic Leadership Council propose the smaller step of universal coverage for children. "It could provide a victory on an issue where there haven't been a lot of wins," says Reed.

Income Security > Help us stay in the game.

If global competition for labor is the future, then government has a role to play in helping us compete. That starts by making sure we have the education to stay a step ahead of Chinese and Indian workers. But in the world of tradable services, Blinder notes, it's tougher to guess which kinds of training will pay off. Hacker says this makes higher education a necessary but risky bet, especially as tuitions rise.

Obviously, policies aimed at making college and retraining more affordable would help. It may be time to rethink unemployment insurance, as well. Today's system is based on an old model: Workers lost their jobs when the economy slowed, then returned when things picked up. But what happens to workers whose entire profession shrinks? Many take jobs with lower pay, so Democrats are talking about creating wage insurance to help people make up salary declines.

Layoffs aren't the only source of income volatility. Since the 1970s, middle-class families have increasingly depended upon women's salaries. But women often leave their jobs to take care of children (and some men do too). Salam sees an opportunity for conservatives here. Before the election, he co-wrote a cover



NEW DEAL: Tax-funded Social Security for the elderly

NEW NEW DEAL: Social Security plus individually funded savings accounts

story for the influential journal *The Weekly Standard* arguing that

Republicans should do more to help the middle- and working-class voters who had been key to their political dominance. Among the proposals: bonuses or expanded tax credits for having children, and subsidies for parents who stay at home to care for children, including, perhaps, tuition assistance to help them retrain when they go back to work. "Republicans have a chance to frame the agenda," says Salam. "Raising children is important, so important that it's unfair it's not recognized."

How much of this will see the light of day, given a costly war and a huge federal budget deficit? An emboldened Democratic party may not be looking to work with Bush, who hasn't exactly been a model of bipartisanship. Then again, Democrats need to show they can govern. And the lame-duck President is thinking about his legacy. That may be enough to get a real conversation going about how to reshape public policy to lessen the stresses of the Anxiety Economy—without losing the opportunity of the New one. **\$**

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Don't Wait for Uncle Sam

Three ways to protect your family in the Anxiety Economy

13 SAVE FOR MORE THAN RETIREMENT Incomes are more volatile, and there's a risk that your next job might pay considerably less than what you're making now. That means you may need to tap some of your savings while you're still working. Yale's Jacob Hacker recommends trying to turn such volatility in your favor by starting what he calls a "sunny day" fund: Whenever you get an unexpected windfall, sock it away immediately.

24 GET YOUR KIDS A 21ST-CENTURY EDUCATION First, don't overpay: If your kid's future job disappears, crushing student-loan debt won't help. Second, tell your young scholar that a degree isn't enough. Princeton's Alan Blinder says your child will need people skills and creativity to distinguish himself from someone at the other end of a broadband line. Third, consider professions that require in-person contact. "An electrician cannot be offshored," Blinder says.

38 ENSURE INCOME FOR LIFE Traditional pensions are on the wane, and that means you'll have to do more on your own to stretch your savings over retirement. That's why economist Jeffrey Brown of the University of Illinois says that more retirees should consider an immediate annuity, which guarantees a lifetime income. Be careful: Many annuities salesmen will sell you expensive policies that have risky investment features. For more, see cnmmoney.com/annuities.