

June 2007

TO: Interested Parties
FROM: Anne Kim, Director, Middle Class Project
Jim Kessler, Vice President for Policy
RE: **A New Middle Class Compact**

Introduction

This memo offers policymakers a fresh and potentially powerful way to address middle-class anxiety and answer the challenge of how to help Americans prosper in a fast-changing modern economy. The ideas, insights, and narrative contained in this paper are based on our recent report, *The New Rules Economy*, which seeks to tackle the defining economic challenge of our time: how to make globalization work better for America and average Americans.

This paper consists of three key elements:

- An overarching **narrative**—the “New Rules Economy”—that sets the context for a new policy agenda aimed at the middle class and lays out a positive future vision;
- Key **insights into the middle class** – the wealth and mindset of the working age demographic upon which this narrative is based; and
- A new “**compact with the middle class**” that begins to modernize and reform government to solve middle-class problems by addressing the new rules realities of the 21st century.

The Narrative

A compelling narrative is critical if progressives are to persuade Americans that they truly understand middle-class economic circumstances and challenges. Without that context, a mere list of policy ideas—no matter how sensible—is insufficient.

The narrative we lay out below draws on our major insights about the middle class and addresses the root cause of middle class anxiety: the rapid and unsettling change brought on by a global economy. It simply and accurately describes an economic worldview that we think will ring true for mainstream Americans while offering them a roadmap to success. Moreover, this narrative comfortably fits with a forward-looking policy agenda that progressives can readily support.

“Middle-class Americans are anxious, because they know the rules for success have changed. For six years they have been told by right wing leaders to deal with the forces of change on their own. It is time for a new compact with the middle class – one that modernizes and reforms government to make it work for the middle class.”

Five Key Insights about the Middle Class

There is no question that middle class anxiety is real. The enormous changes brought on by globalization and the information age have shifted the ground beneath the feet of the middle class and altered the rules of success. It is a disquieting time for many.

But progressives have consistently misinterpreted that anxiety, both substantively and politically. In 2006, congressional Democrats won the middle class outright for the first time since 1990. But our post-election report, *Looking Red, Voting Blue*, which is based on the raw exit poll data of more than 13,000 voters, shows conclusively that it was not economic anxiety that attracted new voters. Rather, the war in Iraq, President Bush's unpopularity, and corruption were the overwhelming factors behind the Democratic wave. Indeed, economic dissatisfaction and anxiety likely contributed only to Democrats holding on to a base group of economically dissatisfied voters.

Based on these exit poll findings, our extensive analysis of public opinion research and the economic data and messages used by both sides, we are convinced that progressives have yet to offer a compelling economic agenda that middle-class Americans believe will either address their anxieties or significantly benefit their lives. Instead, it seems that progressives are heading toward an economic message that is overly pessimistic and drastically underestimates the abilities and optimism of the middle class. We believe this message is based on a significant misreading of the middle-class psyche and on a faulty view of their economic circumstances. Moreover, we fear that it will lead progressives to the wrong policy choices.

Below are the insights into the middle class that progressives must recognize.

Insight #1: The middle class may be anxious, but it is not economically desperate.

In 2005, the median income for households with a working-age head (ages 25-59) was \$61,629. For couples, it was \$72,216, and for two-earner couples, it was \$81,365.¹ This is not an extravagant standard of living, but it is not on the precipice of poverty, foreclosure, or financial ruin. And this income level is far higher than the \$46,326 median household income for all families that progressives normally cite to define the middle class. This latter figure is too blunt to be instructive. It includes households headed by 22-year-olds just starting out and 82-year-old retirees. Because the progressive agenda primarily seeks to increase the earnings and income of prime-age workers, our narrative and agenda should focus on the circumstances of the households we are trying to help.

In addition, while it is true that household debts have increased, household assets have increased faster. Real median net worth grew 35 percent between 1989 and 2004. Among married-couple households, who make up the majority of American households, real incomes at the median grew by 22 percent between 1979 and 2004. Middle-class incomes *may* be more volatile (a debatable proposition), but the likeliest reason is benign - more women entering and leaving the workforce due to childbirth. The "official" savings rate is negative, but that is entirely due to elderly people spending down their assets and the peculiarity of how savings are measured.

This is not meant to diminish the serious problems that many families are dealing with, or to sweep trends like widening income equality under the rug. But it is a warning that a relentless focus on the dire state of the middle class will convince most middle-class people that progressive solutions are meant to solve someone else's problems, not their own.

Insight #2: The middle class is optimistic and aspirational.

Progressives tend to vastly underestimate the desire and ability of the middle class to succeed. Sixty-two percent of Americans disagree that "success is mostly determined by forces outside a person's control."² Sixty-four percent disagree that "hard work offers little guarantee of success."³ To put it simply, Americans are optimists and dreamers. That means progressives must balance their impulse to expand and strengthen the safety net with a robust agenda that helps Americans reach their dreams.

Insight #3: People are not broadly dissatisfied with American capitalism.

Even when people's feelings about the overall economy are negative, their belief in the American economic system is seldom shaken. Eighty percent of Americans believe it's still possible to start out poor in this country, work hard and get rich.⁴ Over the years, between two-thirds and three-fourths of Americans consistently say they are satisfied or very satisfied with their personal finances. And nine out of ten Americans are generally happy with the opportunities they've had to succeed.⁵

Moreover, most Americans are not anti-business. Fifty-eight million Americans (or more than half the workforce) work for large corporations. Four in five Americans say they have strong loyalty to their companies, and two in three Americans say they believe their companies have strong loyalty to them.⁶ Perhaps that is why opinion polls consistently find that the public considers "big government" to be a greater threat to the country than "big business."⁷

We are not suggesting that progressives hesitate from pointing out excesses and righting corporate wrongs, but a narrative based largely on corporate malevolence is not robust enough for the middle class.

In addition, an economic message and agenda that is based solely or mostly on bad news, or one that calls for a major revamping of the economy, does not resonate with most people. In part, this is because recessions are shorter and shallower, and expansions are longer and deeper than in previous eras. Unemployment and inflation have been low for over a generation. The relatively small increase in real median wages over the past 25 years and the widening gap between the very rich and the middle is not enough bad news to create broad dissatisfaction with American capitalism.

Insight #4: Signature progressive policy proposals mostly do not benefit the middle class.

Raising the minimum wage and expanding programs like the Earned Income Tax

Credit, Pell grants, Head Start and the State Children's Health Insurance Program are vital to our nation's well-being and must remain central planks of the progressive agenda, but they are not part of an agenda for the existing middle class. For nearly all households with between \$40,000 and \$100,000 in income – the heart of the working-age middle class – these programs are irrelevant to their daily challenges.

That's not to say that middle-class people do not support such poverty programs – most do. That's why support for those programs polls very well. But they do so out of compassion and communitarian spirit, not self-interest.

Rather, the policies that will most benefit the existing middle class – and will consequently resonate with them – are those that flow from the framework we lay out in this paper and in *The New Rules Economy*: college affordability, paid family leave, child care affordability and quality standards, portable benefits, guaranteed pensions, health care reform, and additional resources for eldercare, to name a few.

Insight #5: Public faith in government is low.

Part of middle-class anxiety derives from a perception that government is often irrelevant, if not an actual obstacle, to meeting people's economic goals. One of the most destructive legacies of right-wing rule has been the erosion of public faith in government as an active force for good in people's lives. A 2007 Pew poll finds that 62 percent of Americans think that "when something is run by government, it is usually inefficient and wasteful."⁸

Thus, progressives cannot simply advocate the expansion of existing programs. They must instead demonstrate the desire to reform government so it is more effective, can better deliver results and is focused on the 21st century needs of America's middle class. Being a reform proponent will also help overcome the "tax and spend" baggage that comes with the turf.

A New Compact with the Middle Class

Modernizing government to help people succeed in the new rules economy is the core of our proposed compact with the middle class. In our report, *The New Rules Economy*, we outlined the rules for success that have changed for people, families, and business. In laying out each of these rules, we also found government policies that are out-of-date and often irrelevant to the way things work now. These gaps in public policy indicate where government has so far failed to adapt to the new rules and has left the middle class on its own.

We've summarized our proposed compact in the form of a series of promises to the middle class, together with sample policy ideas designed to be part of an immediate middle-class policy agenda that Congress can move forward in the near term.¹ Over the coming months, Third Way will be developing and releasing a robust menu of ideas for each element of this proposed compact.

¹ See our report, *The New Rules Economy*, for a full treatment of what we believe the longer-term policy goals for the middle class should be.

New Rules Reality 1:

In the New Rules Economy, a high school diploma is no longer enough to guarantee middle-class success. Success now requires a college degree. But while nine in ten Americans eventually finish high school, four in ten students drop out of college.

Government should be doing more to relieve the growing financial burden of college and relieve the anxiety of parents worried that their children aren't being prepared to succeed.

Promise 1: To make college more affordable and ensure that students are better prepared to earn a degree.

Sample policy option: A generous college tuition tax credit.

New Rules Reality 2:

Under the old rules, steady jobs were in factories; today's steady jobs are in offices. In 1960, 1 in 3 workers worked with their hands; today, 7 in 8 workers work with their brains. It's as important to work smart as it is to work hard, and workers must continually upgrade their abilities to increase their earnings. Government should be providing all workers with more opportunities to return to school and acquire new skills so that everyone can continue moving up the career ladder.

Promise 2: To provide continual opportunities for adults to upgrade their abilities and increase their earnings and income.

Sample policy option: Expand the availability of federal student loans to non-traditional (adult) students.

New Rules Reality 3:

Under the old rules, businesses could afford rising wages and generous benefits for their employees. Now they are competing in a global economy, and soaring health care costs have made yesterday's calculation difficult. In fact, rising health care premiums cut \$3,250 a year from the paychecks of average workers. We now have to rein in health care costs and shift some of the burden away from businesses so they can readily increase wages while remaining globally competitive.

Promise 3: To make quality health insurance more affordable for businesses and individuals.

Sample policy option: Enable small businesses to pool together to purchase insurance for their workers at lower prices. (HR 1955 and S2510 in the 109th Congress)

New Rules Reality 4:

Climbing the ladder once meant rising up the ranks within the same job; today it means chasing opportunity. Over the past 20 years, the median number of years that a man will stay at one job has declined by nearly half, from 17 years in 1983 to 9.5 years in

2006. But changing jobs to get ahead shouldn't mean risking health care coverage or leaving pension money on the table. It shouldn't mean having five different 401(k)s or wondering whether you'll have to switch pediatricians. Government policies should stop tying workers down and instead help meet their needs. Health care and retirement benefits should be fully flexible and portable.

Promise 4: To make health and pension benefits hassle-free so that benefits are as mobile as today's workers and coverage is simple and secure.

Sample policy option: More help for workers who need to consolidate or manage multiple 401(k)s.

New Rules Reality 5:

Most mothers once expected to stay at home. Today's mothers expect to work. Two-thirds of mothers with children under 6 work outside the home. Government policies should be better geared to the modern world of two-breadwinner households. That means helping parents balance a career while raising healthy, happy children and helping households manage the anxieties of caring for aging parents.

Promise 5: To relieve the stress on modern families who are coping with work, raising children and caring for aging parents.

Sample policy options: Paid family leave; elder care tax credit.

New Rules Reality 6:

The American Dream once meant owning a home; today, it means owning a home and a stock portfolio. A house bought in 1960 for \$11,700 would be worth \$166,000 today. Had the same amount been invested in the S&P index; it would be worth \$1,364,000 today. If Americans are to truly share in the nation's wealth, every American should be an investor. In today's world of 401(k)s, government should be doing more to making saving and investing for retirement early, automatic and easy.

Promise 6: To let all Americans reap the benefits of the growing U.S. economy through stock ownership.

Sample policy option: "Worth at birth" accounts with an option to invest in the federal Thrift Savings Plan; federal match for 401(k) contributions.

New Rules Reality 7:

In the past, successful companies built; today's successful companies create. Our nation leads the world in talent and new technologies, and we should be doing everything possible to keep it that way. But in 2005, the federal government spent 33 times more on maintaining interstate highways than on establishing the nation's information highways via broadband. Government should be doing more to create and keep jobs here in America by helping our companies grow and thrive at doing what they do best.

Promise 7: To establish a pro-growth economic environment that continues to create high-paid American jobs.

Sample policy options: Increased investments in broadband and scientific research.

Conclusion

For years progressives have convinced themselves that they were connecting with the middle class. Public opinion polls consistently showed that progressives were more trusted on health care, education, and jobs. But if elections are proxies for real support, the middle class has consistently voted for conservatives until this past November. Through these elections, the middle class has been trying to send progressives a message.

They are telling us that they are not generally worried about losing the basics of financial security—their jobs and their homes—but what was once predictable and sure for themselves and their children now seems unpredictable and uncertain. Americans' lives are filled with complexities; the world moves faster; technology keeps evolving; and the nature of work is changing.

In 2003, the Pew Global Attitudes Project released the latest of its landmark surveys on attitudes around the world toward globalization. It concluded that despite popular support for the conveniences of modern life (e.g., cell phones and the Internet), "people are not entirely comfortable with the economic, technological and cultural change going on all around them."⁹ Forty-eight percent of Americans, for example, said they did not like the pace of modern life, and 67 percent said "our traditional way of life is getting lost."¹⁰ Nevertheless, Americans know in their gut that we cannot turn back the clock. As anxious as Americans are about globalization, only 15 percent of Americans in 2002 said globalization should be stopped.¹¹

As progressives, we believe the middle class is the engine of the economy, and when it succeeds and prospers, so does America. We also believe that a prosperous middle-class is a necessary first step for renewing the political will to lift the fortunes of those not yet in the middle class.

These core convictions form the foundation of our strategy and the foundation of what we believe will be an enduring framework for future progressive policy and vision.

¹ Analysis of data from U.S. Census Bureau, Current Population Survey, March Supplement.

² Pew Research Center for People and the Press, "Trends in Political Values and Core Attitudes: 1987-2007; Political Landscape More Favorable to Democrats," March 22, 2007.

³ Ibid.

⁴ New York Times Poll, Class Project, March 3-14, 2005, 1,764 respondents.

⁵ Kim, A. and Kessler, J. *The Politics of Opportunity*, Third Way, May 4, 2006, citing National Public Radio/Kaiser/Kennedy School Poll, Poverty in America, January 4-February 27, 2001, 1952 respondents.

⁶ Kim, A. and Kessler, J., *The Politics of Opportunity*, Third Way, May 4, 2006, citing Gallup Organization survey, August 9-11, 2004, 1017 respondents.

⁷ Kim, A. and Kessler, J., *The Politics of Opportunity*, Third Way, May 4, 2006, citing Gallup Organization, Gallup Poll Social Series: Lifestyle, December 5-8, 2005, 1013 respondents.

⁸ Pew Research Center for People and the Press, "Trends in Political Values and Core Attitudes: 1987-2007; Political Landscape More Favorable to Democrats," March 22, 2007.

⁹ Pew Global Attitudes Project, "Views of a Changing World: 2003," June 2003.

¹⁰ Ibid.

¹¹ Chicago Council on Foreign Relations and German Marshall Fund of the United States, Worldviews 2002 Survey, conducted June 1-30, 2002, 3,262 respondents.