GENE SPERLING

Rising-Tide Economics

In the twenty-first-century economy, growth and equality must go hand in hand.

In my White House days, I was known for tormenting the speechwriters by insisting that we should rip off Ben Franklin's caution that we "must indeed all hang together, or . . . hang separately" with the economic refrain "we will grow together or grow apart." My line never made it into a speech, but with the spread of globalization it has never been more apt. Indeed, the question of whether spreading globalization and information technology (IT) is strengthening or hollowing out our middle class may be the most paramount economic issue of our time.

Perhaps a better phrase to capture the notion of shared prosperity was John F. Kennedy's observation that "a rising tide lifts all boats." For progressives, the rising-tide metaphor is not a causal assumption that growth will automatically raise everyone. Rather, it is the aspiration and test for economic policy: Does it

GENE SPERLING *is a former national economic adviser to President Bill Clinton, a senior fellow at the Center for American Progress and the author of* The Pro-Growth Progressive.

both raise the tide and lift all boats? This vision of shared prosperity is not only demanded by the global, interdependent economy, but rooted in the historic values of the progressive vision of the United States. Moving forward, we must recognize that the economy is undergoing a profound transformation, making it distinct from both the industrial era and even the beginnings of the Internet Age just a decade ago. In such a world, economic growth can be explosive, but growth alone is not enough. For Americans, shared prosperity, an opportunity for upward mobility, and economic outcomes determined more by merit than the accident of birth are fundamental to who we are as a nation.

The New Productivity Decade

Developments over the last decade emanating from the expansion of globalization and IT have greatly enhanced the need for "Rising-Tide Economics." During this "New Productivity Decade" (1995 to 2006), globalization, investor confidence, a diffusion of information technology, and the end of the Cold War came together to spark efficiency and productivity in everything from inventory management to personal finances. During the first half of this decade, productivity—after languishing for 20 years at 1.6 percent annual growth—took off in 1995, averaging 2.6 percent over the next five years. It was a perfect example of the rising tide lifting all boats: As productivity grew 13 percent overall from 1995 to 2000, median family income kept up, growing 11 percent. From 1993 to 2000, every economic quintile saw income growth above 16 percent, with the strongest growth (23.4 percent) among the bottom 20 percent of earners. During the second half of this decade (2001 to 2006), while productivity kept expanding at an average of 2.8 percent per year, the story on shared prosperity could not have been more different. From 2000 to 2005, the typical working family saw its income fall 2.3 percent. And real wages actually fell for the first four years of the recovery. Rising productivity and historic corporate profits even seemed predicated on disappointing wages: Goldman Sachs found that more than 40 percent of record corporate profit growth of the last five years was due to the historically low share of national income going to labor. The contrast with the previous five years could not have been starker.

A significant difference between these two halves of the New Productivity Decade is that during the second half, globalization and IT dramatically expanded the capacity of workers from around the world to contest American middle-class service jobs. While jobs at the top and bottom of the income ladder that require a physical presence or face-to-face collaboration were less affected, an increasing number of jobs seemed to be falling into what economists Lori Kletzer and Brad Jensen have called the "tradable services" category: white-collar service

jobs capable of being performed in a vast number of global locations. As a result, tens of millions of traditionally middle-income service and manufacturing jobs face downward wage pressure. This isn't a short-term trend. According to Harvard's Richard Freeman, it could take more than 50 years for labor costs in China and India—over 40 percent of the global labor market—to reach parity with those in the United States. The result, as labor economist Lawrence Katz has found, is an increasing polarization of the workforce, with inequality rising more between the top 10 percent and the middle, rather than between the middle and the poorest deciles.

Comparing the economic evidence from both halves of the New Productivity Decade underscores the imperative for economic policies that are focused on both growth and on ensuring that its benefits are widely shared. Globalization is making competition fiercer and the need for flexibility, innovation, top-notch human capital, and access to global supply chains greater, and yet global labor competition also offers the specter of downward wage pressure and dislocation for an increasingly broad cross-section of the workforce. Nevertheless, conservatives, such as columnist George Will, point to respectable GDP numbers and call those complaining about polarization and income inequality "economic hypochondriacs" who can always find a small cloud on the sunniest of days. Yet the strength of the economy should always be measured by how it is affecting the majority of its people. This is a distinctly American view. In the United States, of all nations, shared growth has defined our economic aspirations since our founding. Our framers' fundamental critique of European economies was not based on their growth strategies, but rather on the rigid class structures that led to the spoils of growth being more determined by the accident of birth than enterprise, talent, and hard work. The American vision (though tragically denied to many initially) has been that growth and upward mobility would ensure a broad middle class that always has room for those willing to work and seek new opportunities.

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Supply-Side Blindness: Rising Tide as Trickle Down

For many conservatives, the notion of a "rising tide lifting all boats" is not a test but an automatic assumption that growth—and specifically tax relief to upper-income Americans—will trickle down and lift everyone else up. Supply-siders even argue that Kennedy devised the "rising tide" metaphor to defend his deci-

sion to reduce the absurdly high marginal tax rates that existed at the time. For example, promoting the 2003 Bush tax cuts, former Treasury Secretary John Snow said, "I think it was President Kennedy who talked about 'a rising tide lifts all boats,' when asked to characterize his tax plan back in 1962, I think. There is a lot of merit in that idea." But as his presidential papers reveal, Kennedy never used the "rising tide" line to defend tax cuts of any type. Indeed, the first time he used the line as president was, fittingly, in Colorado on August 17, 1962, to praise congressional approval of a giant dam project.

History aside, the ideological faith in trickle-down economics is wrong on three counts. First, while supply-siders see Reaganomics as a golden period, the 12 years of Reagan-Bush were more like a period of rising yachts and sinking row boats. From 1980 to 1993, average incomes of the top 5 percent rose 62 percent, the top 20 percent rose 34 percent, and the middle was stagnant. The bottom quintile actually saw its income decline by 10 percent in real terms. Second, the "don't worry, be happy" attitude of the supply-siders shows a profound blindness towards the increased sense of risk and economic anxiety being felt by working Americans. Fear of outsourcing is not just the province of manufacturing workers; rather, 61 percent of Americans think their or a friend's job may be at risk from globalization. A 2006 Pew Research Center poll found that half of the respondents worried that their children would be grow up to be worse off than they are. And while the Bush Administration's rhetoric may show insensitivity to rising economic anxiety, its economic policies have been like a boxer leaning into a left hook—responding to that anxiety by imposing even more risk on the individual, from partially privatizing Social Security to pushing incentives to move more Americans into an often callous individual health market. Taken together, these policies amount to what Economic Policy Institute economist Jared Bernstein calls YOYO ("you're on your own") economics. And finally, their ideological insistence on small government prevents conservatives from embracing growth-maximizing public policies that can help attract high value jobs, encourage more risk taking, and reduce the backlash against globalization, precisely by mitigating the negative effects of job loss.

The 'Rising Tide, Raise All Boats' Opportunity

The progressive response to supply-side economics cannot simply be its mirror-image: policies so exclusively directed at redistribution and combating insecurity that they ignore private-sector growth, upward mobility, innovation, savings, and entrepreneurship. We shouldn't replace a focus on growth regardless of equity with a focus on equity regardless of growth. The answer lies neither in following the 1990s Clinton playbook word-for-word nor in an overreaching populist

reaction focused only on how to divide the 2007 economic pie. The rise in insecurity and wage pressure certainly demands a stronger public commitment to the social compact, as well as greater scrutiny of trade deals than what existed in the 1990s. Yet we must also be cautious of policies that unduly and unnecessarily deny our nation the pro-growth and pro-equity benefits that can flow from fully engaging in the global economy with a stronger social compact.

Becoming more sensitive to the potential downsides of globalization should not cause us to forget its potential upsides. First, the same global supply chain that is putting downward pressure on wages has also proven to be a source of lower-cost inputs for our exports and lower-priced goods for working families. Catherine Mann, at the Peterson Institute for International Economics, finds that the globalization of IT hardware in the 1990s reduced prices for IT in the United States by 10 to 30 percent, contributing significantly to the spread of such technology and productivity gains. Second, while increased engagement with China and India for some may seem to be a threat to current jobs and wages, for our children the major job issue could be access to providing services and products to these nations' exploding middle classes, as per capita income in India and urban China triple in the coming 20 years. Third, we cannot forget that the first half of the New Productivity Decade did demonstrate that when expanded openness and innovation were combined with public policies that encourage work and higher education, the result was a truly tight and higher-skilled labor market, which served progressive goals including a sizable reduction in poverty, a dramatic increase in family incomes for African-Americans, and enhanced private sector efforts to recruit and train traditionally marginalized workers. No public works program can match the job creation that is spurred when the U.S. economy leads in the design and deployment of breakthroughs like IT—and hopefully, in the future, alternative energy.

These cautions should not be seen as trump cards against measures to reduce economic insecurity and inequality, nor as a call for timidity in pursing progressive economic policies. Rather, Rising-Tide Economics should ask how we can best address major economic challenges by raising all boats in the most pro-growth way possible.

A PROGRESSIVE COMPACT ON TRADE

One of the greatest challenges and most controversial issues in laying out a progressive pro-growth economic agenda is international trade. This debate on trade and globalization is increasingly portrayed as an epic battle between the Clinton approach of the 1990s and the populist critique of that approach. Yet, on some issues such as labor standards and adjustment assistance, there has been

more consensus than is often acknowledged. To be sure, there remains intense controversy about whether Bill Clinton should have signed NAFTA 13 years ago, when it clearly contained inferior side agreements on labor and the environment. At the same time, by the end of Clinton's second term, he had negotiated an innovative pact to encourage labor standards with Cambodia as well as the Jordan Free Trade Agreement, which included enforceable core labor standards supported by the AFL-CIO.

In 1994, Clinton and his labor secretary, Robert Reich, were designing far-reaching re-employment reforms with guaranteed long-term funding and with one-stop shopping to make it easy for workers to access employment services. Clinton even proposed health care for workers between jobs in 1998. These plans foundered under a Republican Congress, but despite that roadblock, Clinton tripled worker-dislocation funds and passed a limited re-employment reform bill. These examples illustrate that at least some of the most intense disagreements among progressives over "Clintonomics" are less about policy aspirations than about the trade-offs that were made and, most notably, the fact that Clinton chose to move forward on trade even when he faced opposition from a Republican Congress over more robust adjustment policies and labor standards.

Looking backwards, Clintonites such as myself continue to see the trade and economic policies of the 1990s as contributing to a sound post-Cold War foreign policy and a booming economy that was striking for its degree of shared growth, while critics still believe Clinton's trading policies hurt working families. Yet looking forward, there is room for a new consensus among progressives. There is growing recognition by nearly all that the wage inequality we have seen in the second half of the New Productivity Decade requires a stronger social compact both at home and abroad and less of an automatic assumption that market openings will strengthen, not strain, America's middle class. At home, this means a more ambitious agenda to spur job creation on our shores, increase the pool of skilled workers, and strengthen re-employment assistance. Among trading partners, it demands a stronger commitment to enforcing trade agreements, preventing currency manipulation from countries like China, and better labor standards and partnerships to strengthen safety nets, universal basic education, and the monitoring of labor rights. A commitment to decent working conditions abroad is not about shielding the United States from all low-wage competition. Instead, it is about ensuring that low-wage competition is not based on extreme exploitation offensive to basic human rights: child labor, sweat shops, bonded labor, or the killing or jailing or labor leaders. Thea Lee, policy director and chief international economist at the AFL-CIO, rightly noted this distinction when she explained that the union's claims against China were not about the country's

"right to compete in the global economy on the basis of low wages," but about the "*incremental* cost advantage that comes from the brutal and undemocratic repression of workers' human rights."

The question facing policymakers now is how to proceed. Some promote moving forward—even without progress on a broad new social compact—on the notion that more trade is always better than less. Others call for a complete pause on further trade openings until that ideal social compact is in place. Neither approach is wholly right. A business-as-usual strategy ignores the negative evidence of rising inequality and insecurity, as well as the large holes in our adjustment policies. On the other hand, a blanket pause on all trade agreements would in the meantime reinforce Bushian unilateralism, unduly limit diplomatic and economic progress, and send a negative signal to poor nations seeking to use trade to reduce extreme poverty.

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Rather, we should impose a "staged progress test" on trade policies, based on a case-by-case analysis of the importance of the trade opening and the amount of progress being made toward a richer social compact, both in the United States and abroad. By these measures, there is a principled reason why some progressives opposed CAFTA—where labor standards were seen as being weakened—and supported trade deals with Peru and Panama, where Democratic leaders achieved consensus on the enforceable labor standards implemented in the Jordan agreement.

Rising-Tide Economics also should include a "raising all boats" analysis that identifies and addresses the downside risks of a trade agreement to vulnerable workers on all sides. Such an analysis should not be used to raise the goal posts so high that no trade deal is ever good enough. Nor should it be used to say that any time a trade agreement will cause any dislocation or hardship—regardless of its benefits—that it should be denied. But we should recognize that while there are often widespread humanitarian, national security, and economic benefits to opening foreign markets, we too often fail to acknowledge we have a cost-sharing crisis that allows the downsides of such agreements to be concentrated on select communities and fails to implement policies to spread those costs more equitably.

SMART JOB CREATION

Adjustment assistance for laid-off workers is the pre-nup of public policy—it is the protection you are promised in the case of devastating news. It should be

no surprise that most people would rather figure out how to save their marriage or their job than focus on the counseling or assistance after things go south. Unfortunately, what people most want from government—a plan to save specific jobs or to pinpoint where new ones are coming from—is where government is not the most competent. After all, it was not long ago that the U.S. government was convinced that one of the fastest-growing occupations in the new economy would be travel agents.

So what can the government do to save and create jobs? In the 1990s, with booming job creation, we focused on laying the foundation for job creation with smart long-term investments. This is what former Treasury Secretary Lawrence Summers and I used to joke was a public investment "Field of Dreams" strategy: If we build the right research facilities, have the right preschools and lifelong learning programs, and spread the reach of the Internet, they—middle-class jobs—would come. Implicit in that vision was that the "next big thing" would drive virtuous economic cycles of growth and job creation in ways we couldn't imagine at the time. Today, however, when a large percentage of workers think the nation is going in the wrong direction and are worrying about their jobs, a universal pre-K or research agenda—however good long-term policy—is understandably not the most comforting response.

The challenge for progressives today is to continue their "field of dreams" focus on vital long-term investments in education and modern infrastructure, but also to be more aggressive in devising policies that answer the "where are the new jobs coming from" question without falling into the trap of "picking winners" or relying on large public works programs. First, we should be focusing our policies on making the United States a magnet for good jobs. These days many corporations see themselves as international firms, with little preference about what is performed where, as long as it improves the bottom line. But while these CEOs may feel that their fiduciary duty to shareholders should make them indifferent about where productive investment and high-value jobs are located, it should matter to American policymakers. We shouldn't assume that what is good for GM or Intel is good for Americans; rather, we should look for the intersection of a company's bottom line with the interests of the workers, wages, and standard of living of our people and devise policy accordingly. Take tax policy. Currently, we reward any U.S. multinational firm that operates abroad by letting it defer taxes on operating profits in lower-tax jurisdictions. Companies may be right that they need this tax break to compete for foreign market share in low tax nations. Yet U.S. policymakers should take those arguments into account only if companies can establish that locating in such tax havens ultimately translates into more jobs and better wages at home—an argument

that I suspect is getting harder and harder to make.

Second, we need an investment strategy targeted toward the innovation jobs of the future. Progressives must draw a distinction between the narrower "picking winners and losers" approach associated with industrial policy and strategies that encourage more high-value-added jobs in areas where we know America must be competitive. With the strength of our university system and our capacity to create high-return "clusters" of research parks, universities, and pools of entrepreneurs, the United States should engage in an all-out battle to keep research jobs on our shores. A crucial area of opportunity is energy. Rather than the government seeking to pick a single winning technology or oil alternative or relying on an energy-based public jobs initiative, we need a broad and dramatic commitment to energy innovation, incentives for energy efficiency, and climate-change targets that could unleash new export opportunities and millions of new private-sector jobs.

Finally, while high-wage, innovation-related jobs should be the primary focus of public policy, there is more that can be done to compete for lower-skilled jobs through non-protectionist means. For example, there is no reason there could not be more policy incentives to help poor rural and urban parts of the United States—with lower labor costs—compete for the call-center and back-office jobs that are increasingly outsourced to lower-wage nations.

BALANCING JOB SECURITY AND FLEXIBILITY

Another goal for Rising-Tide Economics is to increase economic security while preserving the flexibility in the U.S. labor markets that leads to growth. We know that entrepreneurial risk has historically been spurred in the United States by the fact that the price of failure is at worst temporary bankruptcy, rather than debtor's prison. But as Yale economist Robert Shiller writes, our current policies may deter personal career risk-taking because of "the knowledge that economically we are on our own and must bear virtually all of the losses we incur." Yet the United States spends only 0.5 percent of GDP on adjustment assistance—half as much as the United Kingdom, and one-sixth as much as Germany and Denmark, according to the McKinsey Global Institute.

An ambitious adjustment-assistance strategy that offers this security must be universal, so that the focus to determine eligibility is not on how jobs were lost, but rather on how benefits best spur re-employment. And it must be user-friendly: If Costco can provide one-stop shopping for life's day-by-day necessities, then the government should be able to have a single toll-free number and one-stop centers that handle all re-employment issues—from unemployment insurance to training to expanded benefits like mortgage assistance. If it fails

on these counts, adjustment assistance will never be able to make a major dent in growing economic anxiety.

Our policy should also recognize that the length of job loss may be more determined by the fall one's community has taken or when specific job classifications come under threat than by whether the overall economy is hurting. We also must do more to create adjustment policies that are "pre-emptive," meaning that they provide options for workers to get assistance and for localities to seek economic diversification before predictable mass layoffs occur.

In addition, we should favor policies, like wage insurance, that both provide economic security and dignity for displaced workers while not creating the disincentives to work that have at times hampered European nations. A 50 percent wage-insurance program would reduce the depth of economic falls: If a worker making $20 an hour were forced to take a new job at $10 an hour, wage insurance would cover 50 percent—or $5 an hour—for a period of years, which could be extended for those in their 50s who may have trouble starting new careers. Yet, because wage insurance is triggered only by finding a new job, it cannot be accused of replicating European disincentives to get back into the workforce. The slowing growth of the U.S. workforce over the next 20 years makes an even greater pro-growth case for a bold agenda for zero-to-five early education, an early college intervention program for disadvantaged and minority youth, and efforts to tear down employment barriers for those with disabilities.

We shouldn't assume that what is good for GM is good for Americans; rather, we should look for the intesection of a company's bottom line with the interests of workers.

To continue to help the working poor advance without hurting job growth, we should use the refundable earned income tax credit (EITC) to supplement a strong minimum wage. Mandating a $12 "living wage" in the private sector could sacrifice some job growth. Yet if we combined a higher minimum wage with an expanded federal EITC for single workers and families with three or more children—and encouraged the expansion of state and local EITCs—we could bring more working Americans out of poverty without providing a disincentive for employers to hire new workers. Reinvigorated unions are another element in this plank. Just as some corporate managers have taken steps that have hurt the competitiveness of their companies, there may be some unions which will make unrealistic wage- and work-rule demands. As the markets will punish management that does not stay on the cutting edge, so will workers reject organized labor leaders who do not adjust to market realities. Policies that restore a

level playing field and combat abusive tactics to quell organizing will empower unions to show their capacity to lead in not only ensuring that layoffs are a last resort, but also in helping companies and families adjust to change.

A PROGRESSIVE WEALTH-CREATION AGENDA

In addition to traditional progressive goals of equality of opportunity and income, twenty-first-century progressives must also be concerned with equality of wealth. Part of the disturbing story on economic inequality in recent years has been the trend toward winner-take-all and loser-lose-all outcomes. Top economic writers like Paul Krugman have documented the amazing leaps of the top 0.1 percent of earners, while others, such as Harvard's Elizabeth Warren, Yale's Jacob Hacker, and the *Los Angeles Times*' Peter Gosselin, have highlighted how far the falls have been for many working families. This story holds for wealth—and not just incomes—as well. Economist Edward Wolff has found that, excluding homes, 92.5 percent of our nation's wealth is held by the top 20 percent of individuals, while only 1.1 percent is held by the bottom 40 percent.

Bush's policies have exacerbated these winner-take-all tendencies. Consider twin brothers with equivalent education and work histories, who each took good jobs seven years ago—one with Google, the other with Lucent. Since the investment community was still betting on Lucent in early 2000 and Google was just getting established, it is hard to say that skill led one to $2 million in stock options and the other to a pink slip. However unfair, those outcomes are the price we pay for a free-market economy. Now consider how the Bush policies exacerbate the outcome. If the brother at Google can find a solid 6 percent return on his $2 million, he can earn $120,000 a year while paying a 15 percent tax rate. The other, who finds a new job at $60,000, ends up paying at far higher rate on his income than his Google twin.

Such a tax policy encourages the very type of perpetual elite that our founders railed against. Restoring the upper-income tax rates of the 1990s and placing a limit on the amount of yearly investment gains subject to lower rates would go a long way to promoting equity. But progressives cannot fall into the trap of only having policies that promote "work over wealth." We need a smart strategy for spreading wealth creation and savings. One way to do that is to start with righting our "upside down" system for savings, in which well-off executives are triple winners, while the people cleaning their offices are usually triple losers. Consider that the averge executive likely benefits from a 401(k)-type plan with generous matching incentives, a menu of additional tax-preferred savings vehicles from tax-preferred accounts, and, because they are in the top 35 percent bracket, a 35-cent tax incentive on every dollar saved. The average

person who cleans their office is likely to have no employer-provided pension, no other tax-preferred account, and if they do in fact save a dollar, they get a mere 10 percent deduction.

In fact, of the more than $200 billion in tax incentives offered for each year for savings, only 10 percent goes to the bottom 60 percent of Americans. This upside-down system is a disgrace from both an equity and a growth perspective. Unlike savings incentives for working families, incentives for upper-income families cause a shift of existing savings—not an actual increase in new private savings. On the other hand, Eugene Steurle has shown that if the bottom half of households each saved only $500 more per year, this would raise national savings by 26 percent overall.

Two ideas which promote wealth creation are a universal 401(k) and a flat 30 percent tax incentive for savings. The universal 401(k) would be offered to every working family and include matching tax credits and even greater incentives for the working poor. A refundable 30 percent flat credit would mean that both the highest-paid executive and the lowest-income workers at a firm would get 30 percent savings incentives. If such a plan were funded by freezing the estate tax at a $7 million-per-couple exemption (denying a further estate tax cut to only wealthiest three-tenths of one percent of estates), progressives could spread wealth-creation opportunities by offering effective savings incentives to over 50 million households.

UNIVERSAL HEALTH CARE

A final, critical element of a Rising-Tide economic agenda is universal health care. Thanks to our current employer-based system, tens of millions of Americans fear they are only one pink slip or one illness away from economic devastation. Righting this situation is crucial to addressing both economic anxiety and the national shame of 45 million uninsured Americans. Moreover, a plan that lowered health costs and began the process of removing some of the health-care burden from employers could be a win for competitiveness and job creation. While long-term fiscal stability requires addressing Medicare costs, there is no way to do that without turning it into a second-class health care system—unless we are also bringing down overall health care costs. Done right, universal health care could be the biggest—but far from the only—major policy to show our capacity to raise the raise the economic tide while lifting all boats.

Moving Beyond Trade Offs

The great progressive economist Arthur Okun entitled one of his most famous books *Equality and Efficiency: The Big Trade-Off.* Yet it is increasingly clear

that with a careful eye on both raising the tide and lifting all boats, policies that most fit progressive values can be crafted to also be among the wisest pro-growth strategies. Policies that provide first chances to children born into the most disadvantaged environments and second chances to workers dislocated in the global economy clearly promote progressive aspirations of dignity and security for hard-working families and help create a nation where life opportunities are not denied based on the accident of birth. As the size of our pool of skilled workers becomes a more critical economic imperative, such policies become increasingly essential for future economic growth. On the other hand, private-sector growth—even with its unfairness and imperfections—is critical to maintaining the vision of America as a place that can always make room for the next working-poor family, the next entrepreneurs, and the next immigrant without others having to be edged out. Simply put, it is easier to have a melting pot with a growing pot.

The search for rising-tide economic solutions should be invigorated by the knowledge that there are two ways for a nation to grow apart. One is to have growth whose spoils are seen as rigged for the privileged and against a growing and inclusive middle class. The other is to have a stagnant economic pie, where expanding opportunity for one segment of society is seen as leaving a smaller slice for everyone else. During this time of global competition and technological change, we have an obligation to do all we can to ensure we are growing together—not apart. D