

SKILLS, OWNERSHIP, AND ECONOMIC SECURITY

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Thank you for inviting me to speak today. I would like to begin with a few words on the state of the U.S. economy.

U.S. Economy

About a month ago the Council of Economic Advisers, working with the Treasury and the Office of Management and Budget, released an updated economic forecast. The forecast—which will be used in the Mid-Session Review of the Budget tomorrow—is similar to the forecast released last December and used for the President’s FY 2006 budget. In brief, the economic recovery continues to be strong. With real GDP growth at 3.8 percent in both the fourth quarter of 2004 and the first quarter of 2005, last December’s forecast of 3.4 percent real growth during 2005 appears to be on track, despite the challenges created by high oil prices. Professional forecasters outside the government take a similar view.

The job market continues to strengthen as well. Payroll employment has increased by about 181,000 jobs per month during the first half of 2005, in line with the forecast of 175,000 jobs per month released in December. The revised forecast now predicts that 178,000 jobs per month will be added during 2005. The unemployment rate has been declining for two years and has now dropped to just 5.0 percent, the lowest since September 2001. Estimates of growth in wage and salary income have been revised upward substantially, raising the possibility that the labor market may be even stronger than we thought. One consequence of the strong income growth we are enjoying is higher than expected levels of tax collections so far this year, which if maintained with spending control will reduce the government’s budget deficit for this year well below its projected level.

Inflation remains low by historical standards. While overall inflation has been pushed up by the surge in energy prices, core inflation remains stable. We expect the United States to continue to enjoy price stability over the next few years.

The market for residential housing has been remarkably strong recently, in terms of both new construction and home prices. Homeownership has reached an all-time high during this Administration, as now nearly seven of ten American families own their own homes. The increase in house prices has recently received much attention in the media. While speculative behavior appears to be surfacing in some local markets, strong economic fundamentals are contributing importantly to the housing boom. These fundamentals include low mortgage rates, rising employment and incomes, a growing population, and limited supply of homes or land in some areas. For example, states exhibiting higher rates of job growth also tend to have experienced greater appreciation in house prices.

The Administration will continue to monitor these developments. However, our best defenses against potential problems in housing markets are vigilant lenders and banking regulators, together with perspective and good sense on the part of borrowers.

In all, we are in the midst of a healthy and sustainable economic expansion. Aided by the President's policies and low interest rates, the economy has recovered from an investment bubble, recession, corporate scandals, terrorism and war. Perhaps most importantly, these developments re-confirm the importance of having a flexible, market-based economy.

Changes in the Global Economy

In the remainder of my remarks I will address the issue of economic security—what it means in the context of today's world and what we as a nation can do to help our citizens achieve it.

The idea of what it means to be economically secure in America has changed over time. In our parents' generation, people aspired to be like the family in the television show "Leave it to Beaver." Mom stayed home with the kids, and Dad worked at the same company from the day he completed his education until the day he got his gold watch. Within the company, workers moved predictably up the corporate ladder, earning higher incomes as their seniority increased. The company provided health care, training, and a defined-benefit pension, which, together with Social Security, provided the basis for a secure retirement. Government programs and the tax code were designed to promote these arrangements.

It's an idyllic picture, although it's not entirely obvious that it was ever really an accurate description of life in America. Because of lack of education, racial discrimination, and other reasons, large portions of the population could not hope to enjoy this type of security in the decades after World War II. And the American economy has always been much more dynamic than this placid depiction suggests. Over time we have gone from being an agricultural economy to a manufacturing economy to an economy based largely on a diverse array of services. Technology and new products and services have radically changed the types of jobs that people hold. New occupations and professions have constantly emerged, with the U.S. labor market creating millions of new jobs each year to replace millions of others that have come to an end. In the new economy, Ward Cleaver might have left his company to start his own business, while June might have gone back to graduate school when Wally and the Beaver got older.

Whatever its merits or historical accuracy, what is clear is that the Leave it to Beaver model of economic security is increasingly less viable in today's world. Driven by technology, trade, and the emergence of new economic powers like China and India, the world's economy is evolving at an increasingly rapid pace. Global economic dynamism creates enormous opportunities for entrepreneurship, trade, and investment, and there can be little doubt that globalization will be the engine of increased living standards for the foreseeable future, both in the United States and abroad. With historic patterns of production and trade changing, new competition, and the accelerated pace of innovation

and technological progress, the traditional models of economic security must evolve to keep pace with global economic changes.

As the world has become flatter, in Thomas Friedman's phrase, Americans have heard calls for economic isolationism and for the institution of measures to block competition and change. However, retreating from the world in this way is at best a temporary solution and ultimately would be self-defeating, as doing so must inevitably dampen the country's economic dynamism and growth and thus undermine the very basis of its prosperity. For the past century the United States has been the world economic leader, pioneering new industries and new technologies. We have the most productive workers, the deepest and most sophisticated capital markets, and the finest universities and research facilities in the world. Americans will not only be able to compete in a globalized economy, we will be able to play a leadership role. New opportunities for trade and investment will improve the lives of both American citizens and the citizens of our trading partners.

While we embrace the opportunities these changes bring us we must not ignore the consequences for the economic security of individual Americans. Risk and change cannot be eliminated, and Wally and the Beaver (and their children) may have very different lifetime employment patterns, with more changes in jobs, locations, and even in careers, than their parents did. However, these new forces notwithstanding, I believe that we can and should help American citizens achieve a level of security that will allow them to face the new economic world with confidence. We can do so by applying two broad principles.

The first principle is that, in order to feel economically secure, American workers must be fully prepared to compete in a rapidly changing economic environment. We must assure that in this changing economy all Americans can obtain the requisite skills and knowledge needed to fill the jobs of the 21st century. Of course, vibrant economic growth and a strong and flexible national labor market are essential for this objective as well, and good economic policies will help to ensure those outcomes.

The second principle is that American families should have more ownership opportunities so that they have more control over their own economic security. Ownership gives individuals a stake in their future and thus makes them more secure.

President Bush has a broad and aggressive economic agenda that includes keeping taxes low, opening new markets to American products, stopping the spread of frivolous lawsuits, improving health care, and making energy more affordable and reliable. This agenda will improve our competitiveness and make families more secure. Today I will explore just a few of the ways President Bush's policies fit with the two principles of economic security I have just outlined, beginning with the security that comes from having the right skills to compete in the new world economy.

Skills

The first bulwark in the face of rapidly changing economies and job markets is the flexibility and adaptability of the labor force. This adaptability begins with the formal educational system, especially the public schools.

In some respects the U.S. educational system has been successful in preparing our young people to enter the global marketplace. Average educational attainment is high in the United States (more than half of high school graduates now go on to college, more than any other country), and U.S. schools and colleges tend to focus on teaching general skills that are widely applicable (as opposed to providing narrowly defined occupational training). However, it is also true, unfortunately, that some public elementary and high schools do a poor job in preparing students, as compared for example with schools in other industrial countries. For example, a recent international study ranked American 15-year-olds 24th out of 39 countries in math literacy.

The No Child Left Behind Act, signed by President Bush shortly after he took office, has challenged our public schools to demonstrate quantifiable progress in teaching elementary and middle-school children. The Act requires states to set tough standards for reading and mathematics and to undertake corrective action for schools that consistently fail to make progress in meeting those standards. Children in poorly performing schools are eligible to transfer to better-performing public schools, including charter schools, or to receive supplemental educational services. The governing principles of No Child Left Behind are accountability and inclusiveness. For example, a school cannot meet its requirements under No Child Left Behind only by achieving high scores on the average. The school must also show that it is raising achievement for often underserved groups such as the poor and ethnic minorities. Ultimately, No Child Left Behind will help ensure that our entire workforce, not just the privileged few, have the skills needed for success in the global economy.

In addition, by trying to give children the ability to transfer out of failing schools, the No Child Left Behind Act aspires to allow children and parents to vote with their feet. This can create pressure for change. More broadly, President Bush continues to support school choice programs on a pilot or experimental basis, for example, by including a \$50 million Choice Incentive Fund in each of his last four budgets. Allowing pilot programs like those envisioned by the Choice Incentive Fund is extraordinarily important and should be welcomed by all who have a sincere interest in better serving our students. One program that has been passed, and whose results will be watched with interest, is the DC Choice Incentive Fund, which will support nearly 2,000 scholarships for low-income school children this year in the District of Columbia.

Strengthening our schools is important, but the pace of change in the modern economy means that job training and the acquisition of skills must be a lifetime endeavor. To participate fully in the modern economy, some people may need to acquire new skills in their forties, fifties, or beyond. How can we help make these opportunities available?

Providing continuing training for the workforce should be a public-private partnership. On the public side, the government assists displaced workers by providing support for job training programs. In 2005 the federal government will disburse job training funds in the amount of \$15 billion, with much of the money going to the states for local programs, including the operation of One-Stop Career Centers, which provide services both to employers and employees. President Bush recognizes the important role that vocational schools, technical colleges, and junior colleges can play in retraining the workforce. He recently requested, and Congress approved, \$250 million in job training grants for community and technical colleges to train workers in high-growth industries.

Although current job training programs are useful, we could improve outcomes for workers by updating the design of the current system. Currently, job training funds are disbursed through more than 40 federal programs, each with separate rules and reporting requirements. The system could be streamlined and made more worker-centered and more focused on outcomes. To achieve these goals, the President has put on the table a Job Training Reform Proposal. The Proposal would consolidate four major funding streams and provide governors with more flexibility but also with more accountability, in that they would be required to report on the rates of job retention and the earnings of people receiving training.

The President has also proposed Personal Reemployment Accounts to help unemployed Americans who face the greatest difficulty finding work. Under his proposal, these Americans would receive an account of up to \$3,000 – above and beyond any traditional unemployment insurance benefits – to use in their job search. Individuals could then use this money to pay for job training assistance, child care, transportation, relocation, or other services that would help them find a new job. And if the worker finds a new job quickly, he or she would be able to keep the balance of the account as a reemployment bonus. This incentive can be substantial; studies of similar state-level programs suggest that reemployment bonuses can reduce the average duration of unemployment by about a week. The Department of Labor is currently administering PRAs on a small scale in a demonstration project in seven states.

Even more important for economic security, however, is the way that Personal Reemployment Accounts empower unemployed workers. Traditional assistance programs suffer from the usual “one-size-fits-all” problem of many government programs. PRAs, in contrast, recognize that unemployed workers have a wide range of needs and that no one can understand their own particular circumstances better than they do. PRAs give individuals the flexibility to decide on the best possible match between their own job search needs and the services available. The idea of empowering individuals, rather than working through bureaucracies, is an important one that deserves more emphasis in our thinking about economic policies.

Ownership

Let me turn to the second broad principle, that ownership gives Americans more control over their economic security in the face of a changing economy. For example, to achieve economic security, we should make it easier for people to keep their health insurance policies if they leave their job. This Administration has made the strengthening of individual-based insurance, which is inherently more portable than employer-based insurance, an important priority—not in order to eliminate employer-based insurance, which serves a highly useful function, but rather to provide a viable and complementary alternative.

One important step in this direction is the establishment of Health Savings Accounts, or HSAs, which were created as part of the Medicare bill in December 2003. HSAs are tax-free saving accounts available to individuals when they purchase a high-deductible policy to cover major medical expenses. Basic, high-deductible plans provide insurance against large medical costs but are generally less costly compared to other types of plans. Importantly, individuals have full control over the money in their HSA, spending it when needed and investing it as desired. HSAs can be set up with employers or with outside organizations such as banks, credit unions, and insurance companies. Because an individual or family owns the HSA, independent of employment status, this way of meeting medical expenses is more inherently portable.

To encourage broader use of HSAs, the President proposes to allow individuals who set up HSAs to deduct from their income taxes the premiums they pay for their high-deductible policies, thus reducing the net cost of those policies. He also proposes providing a contribution of \$1,000 to the HSAs of low-income families (those making at most \$25,000 per year), along with a \$2,000 refundable tax credit toward purchase of a high-deductible insurance policy to cover major medical expenses.

One reason that health insurance policies on the individual market can be so expensive is that individual states often introduce various mandates, which can drive up premiums. The President proposes to allow individuals to purchase insurance across state lines, creating a national, competitive marketplace for individual insurance. This measure would help to make individual health insurance more affordable.

Economic change brings other economic challenges. For example, employees of some major corporations have recently found that they cannot count on the defined pension benefits that they were promised, because of the financial difficulties or bankruptcy of those corporations. In a healthy economy, some firms will grow and prosper while others shrink or disappear; these changes while painful for some, are normal in a free-market economy. However, firms should not be able to use their financial difficulties as an excuse to renege on the promises they have made to their employees.

President Bush has proposed a comprehensive pension reform to ensure that companies' promises will not be broken in the future. Central to the proposed reform is better, more market-sensitive accounting, which will ensure that corporations actually put aside the funds needed to make good on their pension promises. Other key measures involve an

increase in premiums paid to the Pension Benefit Guaranty Corporation (to strengthen the PBGC's finances and to reflect market insurance rates), new transparency requirements (so that workers will know if their employers are making good on their obligations), and restrictions on the ability of firms with underfunded plans to make new promises to workers. These commonsense measures for defined benefit pensions will help to strengthen an important pillar of our retirement system, company-based pensions.

President Bush has a variety of proposals to increase the other pillars of our retirement system – Social Security and personal saving. His proposal to help close Social Security's funding shortfall will help ensure retirement security for future generations and his proposal for voluntary personal retirement accounts in Social Security will increase ownership. The accounts will allow all workers, including low-income workers, the opportunity to build a nest egg. They will have an opportunity to earn a better rate of return and to pass on to their family funds from the account when they die.

The President's proposal for Retirement Savings Accounts will reduce the maze of tax-advantaged retirement accounts and his proposal for Lifetime Savings Accounts will help workers create a rainy-day fund that they can use for any purpose, such as home repairs, a health emergency, or education needs.

Promoting individual ownership is the key to providing portability and security. People who control their own retirement savings can worry less about economic events like the loss of a job or political events like changes in promised Social Security benefits. Ownership also empowers workers and their families to take charge of their own destinies, rather than to feel buffeted by forces beyond their control.

Conclusion

I began by pointing out that the traditional model of economic security, based on lifetime employment, has become increasingly less viable in the dynamic economy in which we live today. This change does not mean that we must abandon the idea of economic security, however. Through good policies we can help Americans feel secure economically even in the face of rapid economic change. Achieving this goal will not always be straightforward, but doing so has two major benefits. First, and very importantly, the economic wellbeing of American families depends on their conviction that they will retain some control and security even as they must adapt to changing conditions in the global marketplace. Second, the prosperity of the nation requires that we engage with the global economy, not retreat from it. The more secure individual Americans feel, the more willing they will be to support such engagement.

Thank you.