

Challenges in Today's Economy

You probably don't need an expert or piles of statistics to tell you that these are troubling economic times. Every trip to the gas station or the supermarket confirms the challenges you face. Many families face tough choices today about where to spend their limited income—paying the mortgage or rent, heating costs, food, gas for the car, health insurance premiums, and on and on. For some, routine concerns about rising costs are compounded by uncertainty about their job security or whether their business will be able to survive for much longer.

You don't have to become an economics professor to understand the forces at work in today's marketplace that impact your pocketbook, but it's helpful to get some perspective about the economy we're in and what you can do to ride out bad times. It's also important to remain nimble and optimistic; understand your options, and recognize that things will surely get better (as they always do).

In this chapter, you will learn about the current economic conditions, prospects for the future, and what you can do now in areas including:

- High fuel costs
- Volatile stock markets
- Problems in the housing market
- Rising unemployment
- Uncertain tax rules

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- Low U.S. dollar
- Prospects for recovery

High Fuel Costs

Who cares what the cost of crude oil is on the spot market? You do. Rising crude oil prices, which are of particular interest mainly to commodity traders and oil-producing countries, eventually trickle down to consumers and are felt at the gas pump and in home heating oil prices.

The price of a barrel of oil has hit a new high. In July 2008, oil topped \$147 a barrel and, despite a pullback of the price into the \$120s in early August, many were predicting \$150 or even \$200 a barrel within weeks or months. The rise in crude oil prices is unprecedented. From 1869 through 2006, the price of a barrel of crude oil averaged about \$21 (adjusted for inflation); the price spiked in war years and other periods of conflict in the Middle East.

Why are oil prices so high? There's no simple or single answer. There are many contributing factors, including increased world demand for oil supplies (especially from countries with growing economies such as China and India), a weak U.S. dollar, and speculators (although some experts dispute the ability of speculators to influence prices). Whatever the reason, the price of crude oil continues to climb.

What about the future? No one has a crystal ball, and experts differ on prospects for the future. Some optimists say the price could drop back to \$50 a barrel, while others see \$200 a barrel with no limit in sight. The Energy Information Administration (www.eia.doe.gov/steo), which provides official energy statistics from the U.S. government, posts the short-term outlook for energy, and the numbers aren't good. Even if the U.S. begins offshore drilling, a measure that has been made possible by the lifting of a presidential ban, it might be years before the positive effects of this activity would be felt. In the interim, world fuel consumption, a factor in driving up the price of oil, is projected to grow by a million barrels per day, even as U.S. consumption is predicted to decline. Natural gas, which is used for homes, was \$7.17 per thousand cubic feet (Mcf) in 2007, but it is expected to average about \$11 per Mcf in both 2008 and 2009. The point of these numbers is to make you think about how you are directly impacted—at the pump and in your home.

Gasoline Prices

Everyone who drives a car or truck knows that prices at the pump for gasoline and diesel fuel have skyrocketed within a relatively short period of time.

Who or what is responsible for the price increases? Again, several factors may be at work. Refining capacity (the ability to take crude oil and turn it into gasoline for vehicles) is severely limited (no new refinery has been constructed in the United States since 1976 and the number of refineries within the country has

declined since that time by half). Any weather disruptions, such as a hurricane, reduce refinery production. Less supply means higher prices.

Gasoline taxes are another factor (although some would argue it's a small one). There are the federal excise tax (18.4¢ per gallon), the state excise taxes (averaging 18.2¢ per gallon), and other state and local taxes, including sales taxes, gross receipts taxes, oil inspection fees, underground storage tank fees, and other miscellaneous environmental fees (averaging 10.4¢ per gallon). The idea of a federal gas tax holiday has so far been rejected by Congress.

Some states, including Connecticut and Michigan, had considered a temporary holiday on their taxes on gasoline. There has been only mild support for a federal excise tax holiday; even if enacted it would save only 18.4¢ per gallon. Any tax holiday would merely provide temporary relief and is not a long-term solution to higher gasoline prices.

Home Heating Prices

Like gas at the pump, the price of home heating oil is dependent on the cost of crude oil. Some experts are predicting that the cost of the 2008–2009 home heating oil season could be 25 to 50 percent more than it was in the 2007–2008 season. Someone paying \$2,000 in the winter of 2008 to heat a home might pay \$3,000 in the winter of 2009. For instance, in June 2007, the average gallon of home heating oil in New York was \$2.68 a gallon; in July 2008, it was \$4.68 a gallon, a 75 percent increase in under a year.

Homes heated by natural gas (rather than oil or electricity) are not exempt from higher prices. Prices for natural gas have also risen dramatically this year and could continue to rise in the near future.

What to Do Now

Consider locking in heating oil prices by contracting with your oil company as soon as possible for your oil needs in the upcoming winter season. This will let you obtain the lowest price possible if the price of heating oil rises and will enable you to budget for this expenditure during the heating oil season. (However, if you anticipate prices will fall, then you might prefer to continue to pay as you use oil throughout the winter to benefit from possible price declines.)

Consider obtaining a home energy audit so that you can learn ways to reduce your heating and cooling costs. Most local utilities providers perform these audits for you free of charge or work with third parties to do them for you. Then, if you need and want to make energy-saving improvements (such as adding insulation or upgrading your furnace), you may qualify for very low-interest loans. There may also be state tax breaks for these improvements.

There's more about dealing with energy costs, including tax breaks for making energy improvements, in Chapters 2 and 5.

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Volatile Stock Markets

Why should the average person care about the stock market? There are a couple of reasons. First, more than half of all U.S. households own stocks—directly or through company retirement plans and/or individual retirement accounts (IRAs). Second, stock market data, such as the Dow Jones Industrial Average (comprised of 30 stocks), is headline news every day, creating a psychological impact on consumers who pay attention to this information.

The stock market never moves in a straight line; the prices of stocks go up and down. There have been and will probably be days to come when the market drops significantly in a single day, causing serious concerns that more bad days are in the offing. It is hoped that the trend of the stock market is up over the long term.

Many believe that the stock market can be used as an indicator of when the economy has turned the corner. Historically, the stock market rebounds about six months before the economy as a whole. So when you see stocks going up fairly steadily for weeks (not just a day or two), you can assume, if you believe the pundits, that the worst may have passed.

Will there be a stock market collapse like the one experienced in 1929 that was followed by the Great Depression? According to Milton Friedman, one of the leading economists in the past 100 years, the answer is no, because of current actions by the Federal Reserve (the Fed) and other factors. Today, unlike in 1929, there are some controls in place that will minimize a market collapse.

- The government is committed to using tools at its disposal to ensure that financial institutions can weather certain market activity, such as letting banks and brokerage firms borrow money from the Fed, insuring (for one year) money market funds, banning short selling of hundreds of financial stocks, and giving the U.S. Treasury the ability to buy illiquid mortgage assets from financial institutions. Dr. Friedman argues that the Fed's actions and blunders during the 1920s and especially following the stock market crash of 1929 are the main reason for the depth and length of the depression in the 1930s.
- The stock market has rules in place to halt trading at specific points for specific amounts of time if the market is falling dramatically. This gives investors and speculators in the market a chance to cool down and act more rationally. And the Commodity Futures Trading Commission (CFTC) has introduced new initiatives to address speculative activity.
- Investors' accounts are protected through insurance from the Securities Investor Protection Corporation (SIPC). While this insurance does not protect investors from their own bad investment decisions, it does provide protection in case brokerage firms experience financial difficulties.

What to Do Now

Now is the time to revisit tried-and-true investment strategies to see you through this uncertain time.

- ***Don't panic.*** Don't let emotions govern your investment decisions. Remember, you don't have an actual loss until you sell (unless, of course, the company goes under). If you wait while the market as a whole recovers, your particular investments may ride the up wave. By the same token, however, don't form an emotional attachment to losing stocks that have no chance of recovery.
- ***Invest for the long run.*** Don't try to be a market timer—even experts are often wrong. Instead, make patient and prudent investment decisions.
- ***Diversify.*** If you don't have all your eggs in one basket, your risk of significant loss is minimized. It's rare for all market sectors to decline at once. A well-balanced portfolio can cushion you during volatile market activity.
- ***Buy on the cheap.*** Recognize that a down market is a buying opportunity to pick up quality stocks at fire-sale prices.

There's more about investment strategies in a volatile market in Chapter 3.

Problems in the Housing Market

Fannie Mae and Freddie Mac, the nation's two largest mortgage finance companies, were seized by the federal government in September 2008 in an effort to help stabilize the housing market. The long-term impact of this action is unknown. There are three key indicators of the housing market: home prices, the number of home sales, and the number of foreclosures.

Home Prices

Home prices are important for a number of reasons. They affect what current sellers can receive for their homes. They impact the availability of home equity that can be borrowed by homeowners through home equity loans and lines of credit. They influence how wealthy (or poor) homeowners feel, which can translate into consumer spending (if homeowners feel poor, they may not be inclined to spend money even if there is money on hand to spend).

Housing prices in most parts of the country are down, and some experts predict that declines could last into 2010. Prices of homes in Las Vegas, for example, have already dropped by more than 20 percent. Some pundits are predicting declines of as much as 50 percent in some areas. Of course, there are still some

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bright spots in the housing market, such as New York City and Portland, Oregon, where housing prices have continued to rise in these uncertain economic times.

Someone's bad news is always someone else's good news. Declining home prices may be bad news for homeowners, especially those trying to sell their homes now. But it's good news for home buyers, who can get into the market at attractive prices.

Even home sellers should not necessarily look at the current housing market as a setback. Those looking to trade up or relocate will benefit when they are on the buying end, so even if they don't maximize their return when they sell, they will do so when they buy a new home.

What to Do Now

Your action depends on whether you are a buyer or a seller. If you're a buyer, you're in the catbird seat. Sellers are willing to accommodate reasonable requests and negotiate better terms to clinch a sale. Combine lower housing prices with continued low mortgage interest rates for qualified buyers and you have the formula for great opportunity for many prospective home buyers. And there's a bonus to make things even more affordable: A refundable federal tax credit of up to \$7,500 for first-time homebuyers (\$3,750 for married persons filing separately). The credit, however, applies only for homes bought on or after April 9, 2008, and before July 1, 2009, and the credit, which is effectively an interest-free loan from Uncle Sam, is repaid to the federal government over 15 years starting in the second year after the year of purchase. For example, if you buy your first home in December 2008 and claim the \$7,500 credit on your 2008 return, you must include \$500 on your return each year, starting in 2010.

If you're a seller, you'll have to be realistic in the face of today's home prices. Forget what you could have gotten for your home a year or two ago. Look at comparable *recent* sales in your area to determine current value. If you aren't willing to part with your home at today's price and you can afford to stay put, you can wait out the current housing market and hope for better times to come. No one knows for sure when that will be; some experts are predicting that it could take several years for the housing market to rebound.

Home Sales

The National Association of Realtors (NAR) reported that in April 2008, home sales were down 13.1 percent from the same period the year before, and off 29 percent from the peak in the housing market in April 2005.

Foreclosures

The number of foreclosures and near-foreclosures is alarmingly high. More than 1.5 million homeowners have experienced foreclosure during this current housing crisis. Somewhere between 10 and 30 percent of homeowners are now

underwater, which means their home is worth less than their outstanding mortgage. Once a homeowner is underwater and has no equity, there is a high probability of foreclosure. RealtyTrac (www.realtytrac.com) reported that in April 2008 one in 519 homeowners received a foreclosure notice, and that foreclosures were up 65 percent over the number just one year ago. In July 2008, when Congress enacted the Housing and Economic Recovery Act of 2008, more than 400,000 homeowners were on the brink of foreclosure. The tax implications for homeowners in foreclosure are discussed in Chapter 2.

Rising Unemployment

Because of job layoffs, particularly in certain industries (such as airlines, automakers, and financial companies), everyone in the job market is a little jittery. Those with the least seniority may have the greatest concerns because typically the last one hired is the first one fired. In May 2008, the jobless rate reached 5.5 percent and persisted at this rate through July 2008; in August 2008 it

What to Do Now

Depending on how long or how severe the economic turndown is, no one's job is 100 percent safe. Develop a plan to help keep your job, as well as what to do if, despite your best efforts, you lose it.

- **Improve your job skills.** The more you know and can do, the more likely it is that your employer will keep you. The skills you gain can help you on your current job and, should you need it, to find a new position.
- **Review and revise your resume.** It's always a good idea to have your resume up to date and ready to go, just in case you need it. Also, keep your ear to the ground so you'll know as early as possible whether your job may be in jeopardy; this will enable you to leap into action if it becomes necessary.
- **Understand what a layoff means.** What benefits would you be entitled to from your employer? Could you continue your medical coverage for 18 months under the Consolidated Omnibus Budget Reconciliation Act (COBRA)? If so, what would this cost you? How much could you receive in unemployment benefits? Would you be entitled to any supplemental unemployment benefits from a union? Having this information at your fingertips may relieve some anxiety about the shaky job situation.
- **Develop another income stream.** If you're concerned about job security, it couldn't hurt to have a backup plan to carry you through. This can be done by starting a sideline business. Even though times may be tough, there's always room in the marketplace for new ideas and products, and start-ups can succeed.

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reached 6.1 percent. This is still a historically low number (it reached a high of 10.2 percent in November 1982), but troubling for those who make up this statistic.

The increase in the three-month average of the unemployment rate by 0.3 percentage points has historically been a signal that the economy is in a recession or is about to enter one. This benchmark was met in December 2007, and many take this as an indication that the economy is in serious trouble.

What does the future hold? No one knows whether there will be more layoffs or whether the Economic Stimulus package and other measures will avert higher unemployment. When this book was being prepared, Congress was considering legislation that would enable states to extend the usual 26-week term for unemployment benefits by 13 weeks (by 26 weeks in some hard-hit areas).

If you are laid off, spring into action. Be prepared to spend time every day doing something that will advance your chances of finding a job. This can include networking with family, friends, and former business associates (good thing you already revised your resume). Use technology, such as blogging, which can help you gain visibility and establish your credentials where appropriate. See Chapter 8 for more information about dealing with problems on the job.

Uncertain Tax Rules

Never has there been a time when tax rules have been more uncertain than now. This is due to a confluence of events:

- *Expiring laws.* The tax cuts set in motion in 2001 and 2002 legislation are set to expire at the end of 2010, with old rules scheduled to be back in effect in 2011.
- *Changing administration and new Congress.* A presidential election and a new Congress may bring a new tax philosophy to bear on future legislation.
- *Recurring extensions.* Certain persistent problems have not received permanent fixes, but merely annual attention. For instance, the alternative minimum tax (AMT), which could affect 30 million taxpayers or more if nothing is done, has been undergoing annual patches to prevent this occurrence.
- *Budget deficits.* The continued budget deficit and the need for revenue to service the wars in Iraq and Afghanistan, make stimulus payments (explained later in this chapter), and fund entitlement programs, such as Social Security and Medicare, put ever-increasing demands on the tax system.

In recent years, Congress has taken a band-aid approach to tax policy—fix what must be done now and let major problems and policies wait for another day.

What to Do Now

Stay alert to developments so you can take action when they become official. There may be many proposals discussed in the media, but until they become law, you might not want or need to take any action.

- **Follow tax news and information.** Don't wait until you buy your annual income tax guide or meet with a tax professional who prepares your annual return to learn about new tax breaks and opportunities that apply to you. Use JKLasser.com (www.jklasser.com) for up-to-the-minute information and insight into law changes so you can decide what steps you can take to benefit from them. Also visit the Internal Revenue Service (IRS) web site (www.irs.gov) and your state tax department web site to find out about tax law changes.
- **Factor into your current decisions any potential future tax changes.** For example, if you believe that tax rates will rise in the future, then don't opt to defer income now if you have the opportunity to do so. Take the income now and pay the tax with the expectation that it will be a smaller tax bite than if you delay receipt of the money.
- **Take political action.** Let your U.S. senator and representative know how you feel about proposed tax changes that will affect you. Find them at Congress.org (www.congress.org) by entering your zip code in the search box.

Low U.S. Dollar

When is a dollar not a dollar? When you use it to buy goods and services overseas. Then the value of the dollar is dependent on what it is worth relative to other currencies, such as the euro (used by most members of the European Union), the pound (Great Britain), and the yen (Japan). Over the past several years, the value of the dollar has declined (it is down about 50 percent compared with the euro), which means that your dollar does not go as far as it used to when buying things abroad.

If you don't travel overseas, you might think you aren't impacted by the value of the dollar. Again, economics come into play. Many experts, for example, believe that part of the reason for soaring gasoline prices is the low dollar since oil is, at least for the present, denominated in dollars. Also, foreign investment within the United States is transforming ownership of America because companies and properties here are cheap when priced in foreign currencies. For instance, Anheuser-Busch, a beer company owned by U.S. families for 143 years, is becoming a Belgian company, and a majority interest in the Chrysler

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Building in New York City is now owned by an investment arm of the Abu Dhabi government.

Of course, some view the low dollar as a boon to the U.S. economy because it makes our exports more attractive to foreign buyers. This helps the U.S. trade deficit, which measures the amount of U.S. dollars going overseas versus money coming into our economy.

The bottom line to you is that unless you vacation abroad, you may not be directly impacted by a change in the value of a dollar. Just understand that it could, however, impact the prices of items you buy that have been shipped here from other countries.

What to Do Now

When shopping online, pay attention to whether items are listed in dollars or another currency (with the Internet, it's easy to wind up at a distant site that uses another currency). Determine whether something is really a bargain after you convert the price into dollars.

Prospects for Recovery

Business cycles—expansions (good times) and contractions (bad times)—are a normal part of our economy. Arthur Burns, a noted economist and former Federal Reserve chairman, wrote in 1947, “For well over a century, business cycles have run an unceasing round. They have persisted through vast economic and social changes; they have withstood countless experiments in industry, agriculture, banking, industrial relations, and public policy; they have confounded forecasters without number, belied repeated prophecies of a ‘new era of prosperity’ and outlived repeated forebodings of ‘chronic depression.’” What’s changed today, more than half a century later?

Fortunately, the downturns don’t usually last nearly as long as the upswings. Recessions, defined as two consecutive quarters of declines in the gross domestic product (GDP), occur from time to time. There have been 11 recessions since World War II (the last one in 2001), but these have lasted for shorter periods than in prior times. In the first half of the twentieth century, recessions lasted an average of 18 months; now they typically run only about eight months. The Great Depression, which was a monster recession, lasted 43 months!

The seriousness of recessions has also subsided in the past 50 years. The impact of a recession is judged by two things: loss of jobs and loss of income. During the recession of 1981–1982, the unemployment rate hit 10 percent; in 2001 it was 6 percent. In early 2008, the unemployment rate was just 5 percent. Similarly, the drop in national income (not your individual pocketbook) usually runs about 1 percent to 1.5 percent. Compare these two factors (job loss and

income loss) with declines during the Great Depression—unemployment then was as high as 25 percent and income loss was at 30 percent.

Of course, these statistics are no comfort to you if you have been directly impacted by a job termination or mortgage foreclosure. Things couldn't be more serious or difficult to handle. For most people, the key to getting through difficult economic times is having some perspective, optimism, and good tax and financial strategies. This book is designed to provide you with steps you can take to ease your financial burdens and position yourself for the coming economic upturn.

Congressional Efforts for Recovery

In February 2008, Congress passed the Economic Stimulus Act of 2008, a \$152 billion tax package intended to jump-start the economy. The highlight of the package was the payment of rebate checks (called stimulus payments or checks), which totaled more than \$100 billion in payments to an estimated 130 million taxpayers.

What to Do Now

No checks were sent until 2007 income tax returns were filed. Taxpayers who requested filing extensions had to wait to receive their checks. Many who were not otherwise required to file 2007 income tax returns, such as low-income earners, certain seniors, and certain veterans, could still obtain refund checks by filing a return for this purpose (file a special version of Form 1040A for this purpose).

If you moved after filing your 2007 return and did not tell the IRS about your new address, your check may have gone undelivered (unless you used direct deposit for your income tax refund so that the stimulus check was also deposited directly into your bank or other designated account). Tell the IRS about your new address by filing Form 8822, Change of Address.

If you believe you are entitled to a payment but haven't received yours yet, you can call a special toll-free hotline created by the IRS to answer questions about stimulus payments at 866-234-2942.

Technically, the rebate checks are advance payments of an additional new tax credit on your 2008 taxes. They are not taxable; they are not added to your income for 2008; and they do not impact eligibility for any federal benefits, such as food stamps, Supplemental Security Income (SSI), or temporary assistance for needy families. If you received a rebate check but, based on your 2008 income, would not have been eligible for it, look at it as a gift from your Uncle Sam; you don't have to pay it back. If you did not receive a stimulus payment or the one you received based on your 2007 return was less than what you are eligible for based on your 2008 return, claim it as a tax credit on your 2008 return. Use an IRS worksheet in the instructions to the 2008 Form 1040 to reconcile these disparities.

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The checks, which began to be sent in May 2008, were expected to produce positive results in the economy within about six months. Retail sales in May 2008 had already reflected the \$57 billion in stimulus payments sent out during the month by having a solid 1 percent overall gain (compared with a 0.4 percent gain in April). And the Commerce Department reported in August that the spending of stimulus checks contributed to the 1.9 percent annual growth rate of the Gross Domestic Product (GDP). Is this a sign for optimism? Who knows?

HOUSING RELIEF

In July 2008, Congress passed the Housing and Economic Recovery Act of 2008 to help those at risk of foreclosure avoid this result. The measure lets eligible homeowners trade their high-cost adjustable rate mortgages (ARMs) for lower-cost 30-year fixed rate loans. Participating lenders who want to have FHA loan guarantees can offer new mortgages on no more than 87 percent of the home's current value. For more details, see Chapter 2.

What to Do Now

If you currently have an adjustable rate mortgage, check with your lender immediately to determine eligibility for the new program. If eligible—you must be financially able to pay the mortgage—you may be able to reduce the amount of your outstanding mortgage and replace your current mortgage with a fixed rate 30-year loan.

INVESTOR AND TAXPAYER RELIEF

In October 2008, Congress passed the massive \$700 billion Emergency Economic Stimulus Stabilization Act of 2008 to help loosen up the tight credit market by enabling the U.S. Treasury to buy “toxic” investments from certain financial institutions; this will help them clean up their books and start to lend money that will stimulate the economy. The measure also provides significant financial and tax help to consumers, including a temporary increase in FDIC limits and extensions of many favorable tax breaks through 2009.