

The Phillip Gamble Memorial Lecture

The Political Economy of the Affordability Agenda

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I'm honored to be here to give the Phillip Gamble lecture and want to thank those who helped make this possible, including my old friends Bob Pollin and Gerry Epstein.

I'd like to talk today about the politics and economics of affordability in America.

In one sense, this is a relatively new focus among policymakers, one that stems from a shock to the price level in 2021 and '22. Note that I just cited a shock to the *level* of prices, not their rate of change, aka inflation. I underscore this because my economist brothers and sisters are much more familiar with inflationary shocks than price-level shocks. But I will argue with good evidence that when it comes to affordability, the price level—what things cost—matters distinctly from the price growth rate, or inflation, though of course the two are intimately connected.

In another sense, for many Americans for whom growth has long been more of a spectator than a participatory sport, affordability struggles are as old as economic history. For my whole career, I've focused on inequality, fairness, living standards, capital/labor tensions, full employment, minimum wages, and one can easily recognize such themes in the affordability debate, themes that are familiar from earlier debates about market flaws and power imbalances besetting families who lack the resources to meet their basic needs.

So, if you're thinking what I'm calling the Affordability Agenda—AA for short—is just old wine in a new bottle, I won't argue. But I will underscore that this nomenclature is politically powerful right now. And I will lay some cards on the table.

I am deeply distraught by the current economic policy agenda, or lack thereof. On the conservative side, actions by the Trump administration, sweeping tariffs, deportations, deep budget cuts to health and nutritional supports—cuts implemented to only partially offset the fiscal costs of deficit-financed, regressive tax cuts—and now cost pressures stemming from Trump's war-of-choice in Iran, are all actively pushing the wrong way on affordability, not to mention deeply disinvesting in our future.

On the Democrats' side, at least at the federal level, it is far harder than it should be to point to a developed agenda to address the affordability challenge. There are some examples, particularly around housing, and if we look at sub-national efforts, like those of Mayor Mamdani in New York City or Gov. Spanberger in my state of Virginia—and you'll note I just went from left to center, highlighting the scope of the AA—you'll see ideas taking shape around housing, childcare, and utility costs.

In fact, there's nothing inherently partisan about the AA. People in states both blue and red are challenged by affordability, and politicians on both sides of the aisle claim this mantle. I therefore consider it an important job for economists, policy analysts, professors and students to help the many people wondering who really has their back on this issue to separate the AA wheat from the chaff.

To that end, here's what I plan to cover today:

First, how did we get here? The origins of the AA were in the pandemic inflation of 2021-22, a time when I was in government and have the scars to show it. This requires a quick review of the facts of the case regarding the ups and downs of inflation.

Second, how did a couple of years of high inflation morph into the affordability debate? This part of the talk gets into the price-level shock I noted above, drawing on a forthcoming paper co-authored with Daniel Posthumus for the Stanford Institute of Economic Policy Research, where I'm a senior fellow.

Third, what comprises the AA? Here I'll share a framework I developed with Neale Mahoney, who runs SIEPR. That framework focuses mostly on the price side of the equation, but I'll also provide a policy framework for incorporating incomes and wages.

The Inflation Spike of '21-'22

I'll say least about this, though it is foundational to the elevation of affordability issues. But it's a well-known story, it's pretty straightforward to explain, and while it's central to the *origins* of the AA, it's less so re its current status.

The slide on the left shows the rise and fall of CPI headline inflation; the slide on the right shows the price levels. I included the grocery component of the index, as to this day, this component looms large in the affordability debate. Its weight in the index, by the way, is around 8%, but its weight in people's mental CPI is many, many multiples of that.

When the pandemic hit, three things happened to drive up inflation:

—demands for goods sharply increased;

—supply, including labor supply, was constrained (or, at least, existing supply was insufficient to meet demand, especially for goods); Russia's invasion of Ukraine exacerbated this constraint, especially re energy and food prices;

—strong fiscal support and excess savings supported strong consumer spending.

It was this collision between strong demand and constrained supply that led inflation to spike. Once these forces normalized, at least, as much as they could given Russia/Ukraine, inflation climbed down the other side of the mountain, as you see on the chart on the left. Though both we in the Biden administration and the Fed were pilloried for saying the spike was likely transitory, we weren't wrong. But it was *long* transitory, extended by the war, when a lot of people who heard us say that word thought we were talking about weeks, not many months.

There were nuances, of course. One of the most interesting to me, though at the time it was a lot more painful than interesting, was the nonlinearity of the Phillips Curve. Most macroeconomists believed the negative correlation between unemployment and inflation was quite low. But we found that very low unemployment interacted with tight supply conditions to generate a steeply negative segment of the inflation-unemployment correlation. In English, all that means is that inflation rose faster and further than pre-COVID correlations predicted.

There's also the question of how much did gov't fiscal policy contribute to the spike? Though partisans of course assigned 100% to fiscal support, that claim is belied by the fact that, as you see in this next slide, inflation went up in every advanced economy

over this period. Even Japan, where disinflation and deflation had been the norm, saw an increase in its inflation rate.

That said, there is econometric support for the claim that fiscal policy overfilled the output gap, meaning more than offset the demand destruction caused by the pandemic. Of the seven or so percentage points that CPI inflation rose, from around 2 to 9 percent, 2-3 percentage points can be reasonable assigned to excessive fiscal support.

That's not the whole story, and given that the realistic counterfactual is less—not zero—fiscal support, inflation under any plausible scenario would have peaked at 7 or 8 percent, instead of 9. I doubt that difference changes much in terms of what followed.

But tradeoffs exists, and less fiscal support would likely have meant less poverty reduction, more evictions, greater cutbacks in government services at both the state and federal level, less infrastructure investment, more business closings, and a less quick return to full employment and full capacity GDP growth.

At any rate, back along the path of history that actually unfolded, inflation eventually came down about as quickly as it went up. And yet, when me and my Biden-econ-team colleagues went on WHNL (White House North Lawn), where we spoke to the media, no one took much solace at all from the fact that inflation was falling.

It quickly became clear that the American people were much more unhappy with the price level shock than they were with the inflation shock. The lesson was that after a positive inflationary shock, people and the price level have something in common: they both have a memory.

The Price-Level Shock and the Birth of the Contemporary AA

That memory point sounds a bit obscure but it's central to my thesis so let me elaborate.

In fact, in a statistical sense, both the rate of inflation and the price level have a memory, though the level's memory is twice that of the inflation rate. If I regress the log change of CPI inflation on its one-period lag, I get a coefficient of about 0.5; if I do the same exercise for the level, the coefficient is about 1.

If you then turn to normal people, as opposed to economists, you'll find they have a much better sense of what things cost in level terms than in change terms. And especially if the price level gets shocked, I assure you, they remember what things used to cost and damn it, they want their old prices back! This fact is sadly germane today as folks are experiencing a new price shock from the war in Iran.

Back then, telling folks, as I often did, that grocery inflation has come down from 12% to 2%, which, for-the-record, was truly good news, meant less than nothing to them. Their reaction was some version of: "You want me to feel better because the price of a dozen eggs is growing more slowly?! I want it to fall!"

That's anecdotal, but here's how Daniel Posthumus and I tried to add some rigor to this analysis.

We start with this important disconnect from the UMich sentiment survey [slide]. We generate predictions of the survey using a simple model where the regressors are inflation, unemployment, the change in S&P500 quarterly returns, and the change in real aggregate consumer spending. We estimate the model on data from 1990-2019,

right before COVID hit, and then make out-of-sample predictions of consumer sentiment using actual values for the independent variables.

As you see, the model performs well, and not just for the thirty years of the estimation sample but through the earlier history of the sentiment data as well. But post-pandemic, a large gap appears with the predicted values well above the actual values. We think of that as the affordability gap and this figure shows that it tracks web searchers for “affordability.”

Based on my experience in 2022 and '23, as inflation began to climb down the other side of the mountain yet the economic mood of the American people remained sour, Daniel and I derived a trend-break or price-spike variable, shown in this slide. We estimate a smooth trend in price level through 2019, and, using the average growth rate of this trend from 2014-19, we extrapolate it out to the present. We think of the log difference between this counterfactual trend line and the observed price level as the difference between how folks broadly expected the price level to evolve, and how it actually evolved.

When we add this level-expectations difference into our sentiment model, the affordability gap closes.

We suspect this price-level shock was kindling for the heated affordability concerns that developed over this period. To take a more granular look at that assertion, this next figure compares nominal hourly earnings of middle/low-wage workers with price increases for groceries along with the overall CPI. Each bar represents cumulative

growth over two five-year periods, pre- and post-pandemic, with the latter covering the most recent data through last month.

These two very different wage/price regimes explain a lot about how people experience affordability, one that some commentators miss because they discount precisely this context. A recent Washington Post [editorial](#), for example, argued that because grocery prices and wages were now growing at about the same rate, there's no reason to consider grocery prices as part of an affordability agenda.

But just eyeball the difference between wage and grocery price growth in the two periods and you'll see how the Post's analysis ignores everything I just took you through regarding the affordability gap and price-level memories after a shock. People know that their paychecks used to go a lot further at the supermarket, and if you fail to grasp the salience of the flip in the wage/price dynamics shown in this bar chart, you will fail to grasp why a lot of people are still unhappy about the current level of many prices that are most salient to their market baskets.

The question then becomes, what do we do about it? How should policymakers frame the AA? What do the blueprints of the policy architecture look like? What are some examples of policies that could help people meet the affordability challenges they face?

The AA Agenda

To many of my economist brothers and sisters, "affordability" as the basis for an economic policy agenda doesn't make much sense. The reason is that they mistakenly

think it implies a desire to lower the overall price level, and one of the only ways to reliably do that is to have a deep and long recession.

In a recent NYT oped, I explained my view of the political economics of the AA, developed through lots of work with policymakers and policy analysts.

The AA can be “defined by two simple criteria: First, it is focused on a narrow set of essential, big-ticket items that define the affordability problem for many consumers — including childcare, housing, health care and electricity.” Second, it highlights how market flaws boost these prices.”

There’s nothing in there about the overall price level, and, in fact, for most of what we buy, markets work well and, given that price signals are as important as ever, we always want to avoid messing with them if we can help it.

In search of a policy framework for goods and services that fit the criteria above, Neale Mahoney and I developed this three-legged stool, wherein each leg broadly captures ways to diagnose and prescribe in the affordability space.

The first leg is enhanced supply: While many regulations have societal benefits that justify their costs, removing procedural sludge that makes it too slow and expensive to build will increase the supply and lower the cost of the goods and services that constitute the affordability crisis. For my econ 101 fans, a key part of the AA is simply pushing out supply curves and reducing any barriers that constrain such movements.

The second leg is competition policy: In sectors like health care, food production, airlines, communications, among others, insufficient competition pushes up prices and

reduces choice, all while generating excess profits for existing companies. Enacting pro-competitive policy can promote affordability and increase choice.

The third leg is subsidies. In the cases of housing, health care and childcare, for example, we cannot count on either removing friction-inducing barriers or ample competition to fully ease affordability constraints. Direct subsidies are needed for low and middle-income households to afford these key parts of their family budgets.

We those three legs supporting us, let drill down on some of the tools that can help to operationalize this agenda.

Starting with a “do no harm” principle, the first item in the AA would be roll back Trump’s sweeping tariffs. Though the ensuing revenue loss would exacerbate our already shaky fiscal outlook, doing so would be a straightforward and surefire way to lower costs as these import taxes are jacking up consumer prices and distorting economic production. By rolling back tariffs, policymakers can deliver on a promise to reduce prices on day one.

For the record, it remains the case that as a narrowly targeted tool, tariffs can be a useful and potent weapon against unfair trade. But you want to wield them against “rubber tires, grade four,” not Canada and the EU!

Providing government subsidies for the affordability portfolio sounds good to those looking for quick help, but it works best in settings where supply is elastic enough to accommodate the increased demand. In supply-constrained markets, like housing,

subsidies primarily result in higher prices, reducing their affordability firepower and generating a bigger price tag for the government.

In other words, sequencing matters. Combining consumer subsidies with policies that make it faster and cheaper to build can be an effective one-two punch if we first expand supply through streamlining reforms to allow for faster, less expensive production, followed by demand-side subsidies to address affordability. Getting the sequencing backward risks causing prices to spike over the short run.

When it comes to competition, economists love competitive markets as much as Americans love apple pie. When I talk to standard-issue economists about the AA, this is the idea they like the best. And for good reason: Preventing harmful consolidation and enacting pro-competitive policies will lower prices, raise quality and improve economic efficiency. So, too, will policies that help entrepreneurs and small businesses enter markets and grow their companies without being blocked or otherwise thwarted by powerful incumbent firms.

On the other hand, if you really want to get an economist to clutch their pearls, just say “price controls.” And to be fair to my fellow econ travelers, I too can reach for the smelling salts when a policy maker wants to control prices by fiat. The reason is straightforward: increased supply is often key to the AA, and government price controls because can jam market signals that incent producers to expand supply. In other words, price controls can help some people in the near-term while making life less affordable for many more people over the longer term.

But there are two reasons for anyone thinking about AA policy design to think about price controls. First, if you've ever worked with politicians, you know that most of them heavily discount the future. I'm not throwing shade—the incentives push them hard in that direction. But if they've got a policy that will help people/voters loosen an affordability constraint today, they'll often take it, tomorrow be damned.

Relatedly, Neale and Bharat Ramamurti raise the “affordability time conundrum.” People struggling to make ends meet want and need help today. But even an efficiently designed, low-barrier, supply buildout can take years. For this reason, there's an interesting pattern developing in AA policy proposals: control, cap, or manage a price in the near term, but do so only conditional on two design features: one, the price control is contingent on progress in increasing supply—no supply improvements, no price relief—and two, the control is temporary.

The politically minded among you may see one problem already. Good luck taking off a price control that's been in place for a while. A cardinal rule that can be observed in our increasingly unsustainable budget path is that it's much easier for politicians to giveth than it is for them to taketh away.

But the fact is that some price controls have been both implemented and taken down in recent years, though more in Europe than here, particularly to offset their sharply spiking utility costs after Russia invaded Ukraine. Mexico has a voluntary grocery price control program in place wherein retailers and wholesales who agree to hold down costs in a market basket of essential foodstuffs get a break on taxes and fees. On the

other hand, I'd say the track record on rent control is that it has suppressed supply in precisely the counterproductive way economists worry about.

Okay—let's go down to cases.

Childcare is an essential and often unaffordable component of many family budgets. In the most expensive places across America, childcare can cost more than \$20,000 a year, a burden for even relatively high-income families. Those who need it most, young parents, often don't earn enough to signal the market to supply what's needed in this space, especially at the quality we want for our kids. So, unless a young family is uniquely wealthy, the government must subsidize their childcare purchases. Importantly, unlike housing for example, there do not seem to be steep zoning or regulatory barriers blocking the addition of new childcare supply, and recent [research](#) suggests that robust public investment in the child care sector tends to pretty quickly generate new supply, which helps to restrain price growth.

Based on the framework I've laid out thus far, this is good case for leg two of the stool: gov't subsidies to help families pay for childcare. To be clear, that's a fiscally expensive proposition—viable plans tend to score as costing \$500 billion or more over a decade—and a whole other work stream of mine is to worry and warn people about our unsustainable fiscal path. That, however, is a different and much less fun lecture than this one.

Housing supply—specifically affordable housing—is, of course, also very much in short supply. About a quarter of homeowners and half of renters spent more than 30 percent

of their gross income on housing in 2023. There are tens of thousands of different housing jurisdictions across America, and the one thing they tend to share are zoning rules and other regulatory sludge that discourage developers from building affordable homes. That said, we must also realize that such rules are designed to protect the housing wealth and perceived amenities of incumbent homeowners, who are a powerful political force.

Colleagues from the Center for American Progress and I worked on an affordable housing plan that embodies the principles I've set forth. The plan allows the federal government to use its leverage to encourage undersupplied communities to finance new affordable multifamily housing, expand the production of modular housing and scale up existing local programs that are eliminating barriers to affordable home building. It provides quick rental relief, but only if communities take action to increase the supply of affordable rental housing.

By the way, according to a recent CAP study, Trump's tariffs are adding over \$17,000 to the construction cost of the typical home and reducing building by 450,000 units by 2030, so they've obviously got to go.

Fixing our broken health care market is at the top of the AA. The government plays a huge role in this market through the Affordable Care Act, Medicare, Medicaid, the Children's Health Insurance Program, drug negotiations and more. These programs enable millions of people to get health care they otherwise couldn't afford. But we pay too much for it, relative to both other countries and to American families' incomes.

Our health system is twice as expensive as those of our international peers, suggesting that the government could spend less and consumers could pay less — though many with their hands in the U.S. health-care cookie jar would earn less. Getting there requires loosening rules that restrict the supply of medical professionals, capping hospitals' and doctors' charges, expanding Medicare access and allowing federal agencies to negotiate lower prices on many more drugs than is currently the case.

Electricity costs comprise considerably smaller shares of most household's budgets, but costs have recently been outpacing inflation, and consumers are justifiably worried about externality costs spilling over from data-center buildouts. Politicians are starting to run, successfully, on capping electricity rates and forcing data centers to internalize more of the costs they're adding to the grid. Policy design in this space should pair any short-term relief, whether that's rate freezes or subsidies to users, with policies to modernize the grid and bring more generation on line.

As if we needed a reminder, Trump's war-of-choice in Iran and its impact on energy and other costs, including food, remind us of how counterproductive it is to reverse Biden-era policies to generate more domestically produced renewable energy. Every time somebody says "Hormuz," please remind them that renewables are, by far, the fastest-growing and least expensive sources of increased energy supply.

Each of these ideas — providing young parents with the resources to afford quality childcare, increasing the supply of affordable housing, lowering health care costs, expanding the supply of clean energy enough to lower electricity bills — is realistic. The

party that promises and delivers on this agenda would position itself at that all-too-rare intersection of good policy and good politics.

Before I conclude, I want to be sure to say a few words about the other side of the AA. Affordability isn't just about prices, it's also about wages and incomes, and thus the AA must include policies to help there as well. I will say much less about this part of the agenda not because it's less important but because it is much better known, thanks in part to good works by many scholars from this university.

To make sure that the bakers get a fair slice of the pie they're helping to bake, we need to ensure the persistence of full employment labor markets. The argument goes back to Keynes, of course, and the empirical record behind this point is strong. The bargaining clout of middle and lower-wage workers rises with the tautness of the job market and falls as it slackens. Maintaining full employment is of course one-half of the US central bank's mandate, and Keynesian fiscal policy is also relevant in this context.

At this point, most workers live in states or cities where minimum wages are above the absurdly low federal level of \$7.25. The federal wage floor, last legislated back in 2007, is now largely a southern wage floor, and any AA worthy of support must update that number.

Even with tight labor markets and a higher minimum wage, many working families' incomes will be too low to maintain a decent living standard. To help close this gap, robust work supports, which often take the form of refundable tax credits such as the Earned Income Tax Credit or the Child Tax Credit, must be maintained and, in some

cases, expanded. The CTC, in particular, should be fully refundable, as under its current structure, the nation's poorest families with kids do not get the full credit.

Full employment conveys some degree of bargaining clout, but greater union membership and coverage is the most direct way of raising workers' chances to get a fair slice of the pie. Two necessary reforms in this space include moving from individual workplace bargaining to sector bargaining and significantly increasing the punishment on employers who violate labor laws and illegally block union formation. The current system barely slaps their wrists.

Finally, while we cannot yet know the extent to which AI will displace or complement work, our stance should be to hope for the best and plan for the worst. That plan should include at the very least updating our antiquated Unemployment Insurance system and reforming our worker training system to raise the odds that this technology is labor-augmenting vs. labor-replacing. But it should go further than that, developing potential wage insurance and guaranteed jobs alternatives. Hopefully, we won't need to break that glass, but if so, we should be ready.

Okay, that's a lot of economic and policy granularity, and I thank you for your patience. But let's not lose the bigger picture here.

Our nation faces an existential crisis. Democracy is under threat from an authoritative regime that is unchecked by the very checks and balances the founders of our system intended to block such a threat. But this group is hacking democracy, and as you've

seen if you're paying attention, which I very much hope you are, they're alarmingly good at it.

But they also have a fatal flaw. They have neither the policy chops nor the ideology to craft and implement an AA. And what's surprising to me is that they're not just failing to address people's affordability concerns, they're pushing hard in the other direction. And people know it. You know that UMich sentiment survey I was referencing earlier? Its preliminary result for this month is the lowest on record in a survey that dates back to the 1950s!

It's probably possible for the opposition to defeat this regime based on the fact that they're not them. In fact, there's a decisive group of swing voters who seem quite stuck in a mode of cycling through incumbents until some party actually helps them reconnect their economic well-being to that of the overall economy.

If that's true, as I believe it to be, then crafting and implementing the AA may be our best hope of re-establishing a progressive, lasting, inclusive, worker and family-centered coalition.

For the rest of my time in this business, that's my life work. From what I know of this university and this economics department, I suspect I'm not alone in this existentially important pursuit.

Thank you.