

Affordability, Part I

di Paul Krugman

A group of vocal Remainers, with Alastair Campbell a key member, are urging Keir Starmer to rejoin the customs union – or the EU itself

Campaigns with a lot in common

If you view politics in terms of a left-right spectrum — which talking heads generally do, but voters [generally don't](#) — Zohran Mamdani, New York City's mayor-elect, and Mikie Sherrill, New Jersey's governor-elect — look quite different. Although Mamdani is not, whatever Republicans say, a Communist, he's clearly well to Sherrill's left.

Yet as many observers have noted, in a sense they ran similar campaigns, focusing on the issue of “affordability.” But what does that mean?

Economists tend to equate affordability with “real income” — people's income divided by a measure of the cost of living. Real income is definitely an important and useful concept, and it's important to get our facts straight about the changes in Americans' real income over time. But basing the question of affordability solely on real income is clearly inadequate, both politically and intellectually.

Politically, telling voters not to be upset about the rising cost of living because their incomes are rising even faster — even when it's true — is a good way to lose elections. As I emphasized in [last week's primer](#), in times of inflation people tend to believe that they earned their wage gains, only to have price hikes snatch them away. Lecturing them and saying that they *shouldn't* feel that way is political malpractice.

But political messaging aside, there are good reasons to believe that real income by itself gives an incomplete picture of what people mean when they talk about

affordability. In some important ways the current U.S. economy is worse for workers than it looks according to the most commonly cited economic data.

Moreover, I would argue that three important concepts that are especially poorly captured by standard economic numbers underlie people's perceptions of affordability: *economic inclusion*, *security*, and *fairness*. By economic inclusion I mean the ability to purchase the goods and services that allow someone to feel like a member in full standing of American society. By security I mean a feeling based not just on current real income, but also an assurance that severe hardship isn't just a stretch of bad luck away. Lastly I would also argue that perceptions of affordability are often intertwined with perceptions of fairness: people are especially upset about high prices when they feel that they are being taken advantage of.

Affordability, in short, is a big topic, and I'm planning to discuss it in three successive primers.

Beyond today's paywall I will address the following topics:

- Trends in real incomes
- Why the economy is worse for workers than it looks
- The special problem of unaffordable housing

Next week I'll talk about economic inclusion, security and fairness. And the following week I'll conclude with some thoughts about a general affordability agenda for the Democrats.

Trends in real incomes

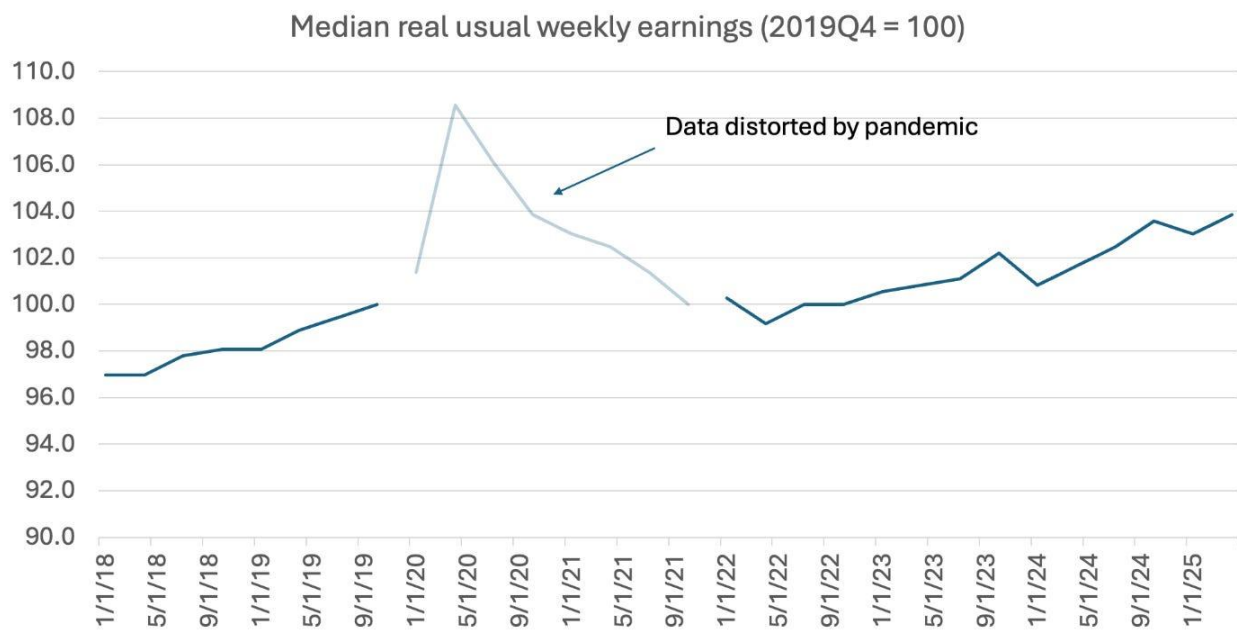
Affordability is a real issue. It's important, however, not to get distracted by a fake issue: The claim that the typical American family has been impoverished by inflation that has outrun the growth in household incomes.

Ever since the inflation surge of 2021-3, stories about the struggles of American families trying to cope with the high cost of living have been a staple of media coverage of the economy. These stories are almost always based on real people: the U.S. economy is huge, marked by vast inequality in incomes and circumstances. Even

in the best of times there are millions of families having a hard time making ends meet.

However, these portrayals give a misleading picture of the economy as a whole. In the roughly 2 ½ years of high inflation the U.S. experienced as the economy recovered from Covid, prices rose rapidly but so did wages. In fact, once the dust settled, the majority of American workers had higher purchasing power than they had on the eve of the pandemic.

Here's a revealing indicator, the weekly earnings of the typical full-time worker, adjusted for inflation, since 2018:



[Source](#)

Following a design idea originally suggested by Arin Dube, I've grayed out the pandemic years, during which wage data were distorted by composition effects. During that period, median real wages appeared to jump temporarily, then fall; but that was due to the fact that low-wage workers bore the brunt of pandemic-era layoffs and were rehired as fear of infection subsided. Looking through that confusing

period, the conventional economic data show that most workers were not impoverished by inflation.

So the common narrative that we have an affordability crisis because prices have outpaced incomes just isn't right. And it's important to understand that.

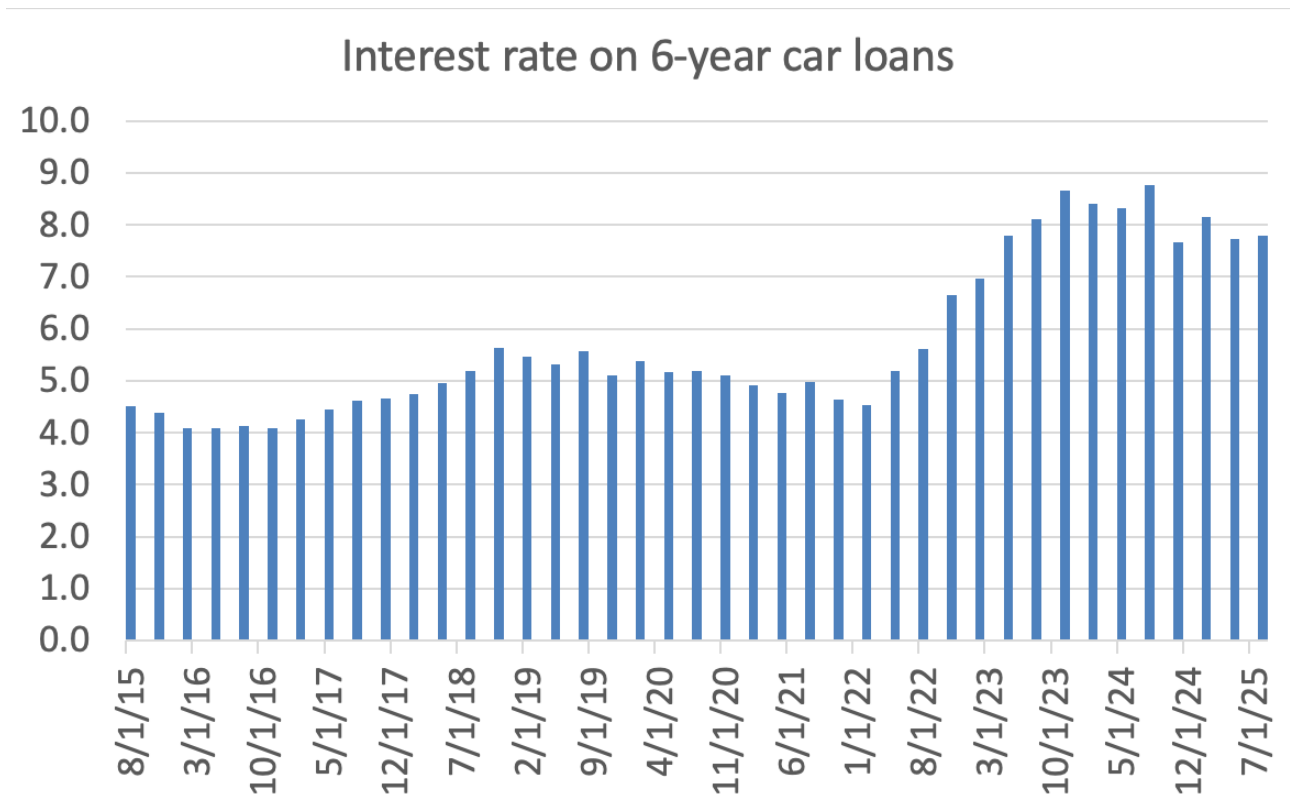
Yet lecturing people and telling them that they shouldn't be angry about inflation, because their incomes are up, is a clearly self-destructive strategy. The only strategy that is worse is the one being pursued by Donald Trump: gaslighting the public and claiming that prices are actually down.

But who's right here: economists and their conventional economic measures, or the public? In reality, there's a case to be made that both are right because conventional statistics don't convey the reality that the economy is worse than it looks for many workers.

Why the economy is worse than it looks in conventional economic statistics

In late October I [wrote](#) that the U.S. economy is, in some important ways, in worse shape than it looks according to conventional economic statistics — especially for those who don't own a large stock portfolio and must depend on their wages to live. Let me emphasize two points in particular.

First, the Consumer Price Index, which economists use to calculate the real wage, doesn't include borrowing costs. This is despite the fact that many Americans must rely on credit to make important purchases — houses, of course, but also consumer durables, especially cars. And interest rates have risen sharply since 2022. Here's the average interest rate on 6-year car loans:



[Source](#)

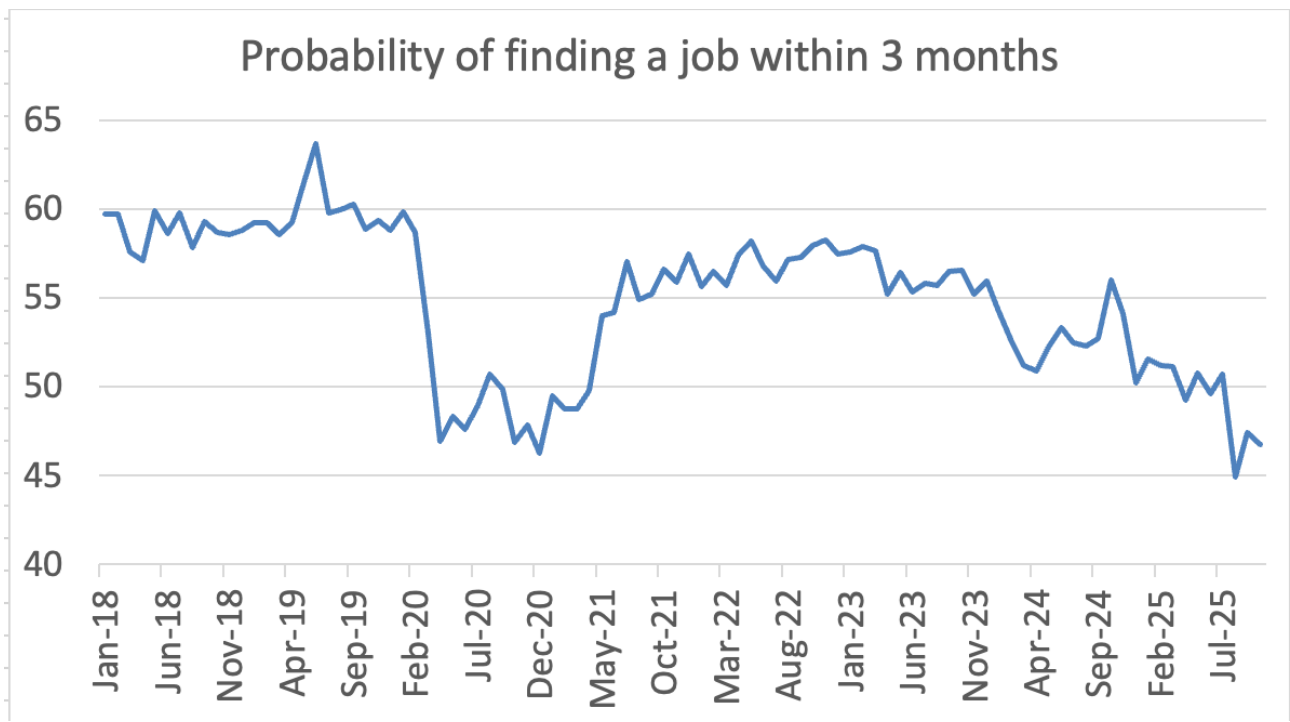
Nor is exposure to interest rates limited to purchases of cars and other durables. A growing number of Americans are using buy-now-pay-later plans to [purchase groceries](#), exposing them to credit costs.

Potentially, interest rates on consumer credit could fall if the Fed cuts the federal funds rate, the interest rate it controls. But the Fed is being cautious about rate cuts, for good reason. Trump’s huge tariff hikes have increased the current inflation rate (as I will discuss next week), and a premature rate cut by the Fed could stoke even higher inflation.

Furthermore, if Trump succeeds in bullying the Fed into making irresponsible rate cuts, the result could be a drastic [Turkey-style surge in inflation](#) that would make current concerns about affordability look trivial.

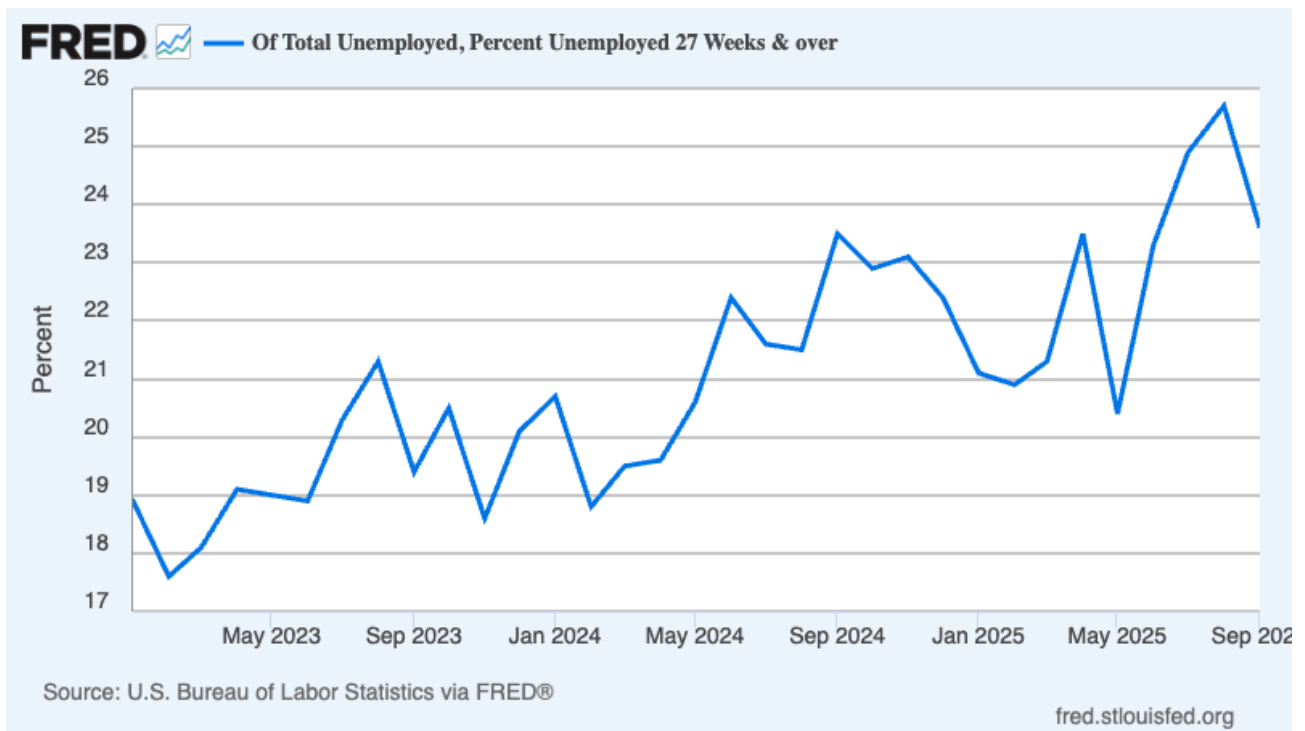
A second important reason the economy is worse for workers than it looks by conventional measures is the frozen job market. There have been no mass layoffs, at least so far, and the number of unemployed workers — Americans who are seeking

jobs but haven't yet found them — is still fairly low by historical standards. But hiring — the rate at which employers are adding new workers — is very low. As a result, it's very difficult for Americans who have lost their jobs or are just entering the labor market to find jobs. The New York Fed asks workers about their perceived likelihood of finding a new job within three months if laid off. As the chart below shows, this perceived probability is near a historic low and far worse than it was pre-pandemic or even last year:



[Source](#)

Because of low hiring, the number of Americans suffering long-term unemployment — defined as having been unable to find a job for 6 months or more — has risen substantially:



Why are jobs so hard to find? The most likely explanation is that potential employers are paralyzed by erratic, highly uncertain policy — especially Trump’s ever shifting tariffs. And the perception that jobs are hard to find adversely affects even those Americans who are currently employed, increasing their anxiety and reducing their bargaining power. You don’t want to make demands at work, such as asking for higher wages, because if you lose your current job you may not be able to find another.

So when I say that the standard claim that prices have run far ahead of incomes isn’t right, I am not saying that all is well with the economy. It isn’t.

And there’s one particular dimension of affordability on which the position of Americans, especially relatively young Americans, has gotten substantially worse, not just recently, but over the past couple of decades: Fewer and fewer young workers are able to buy houses.

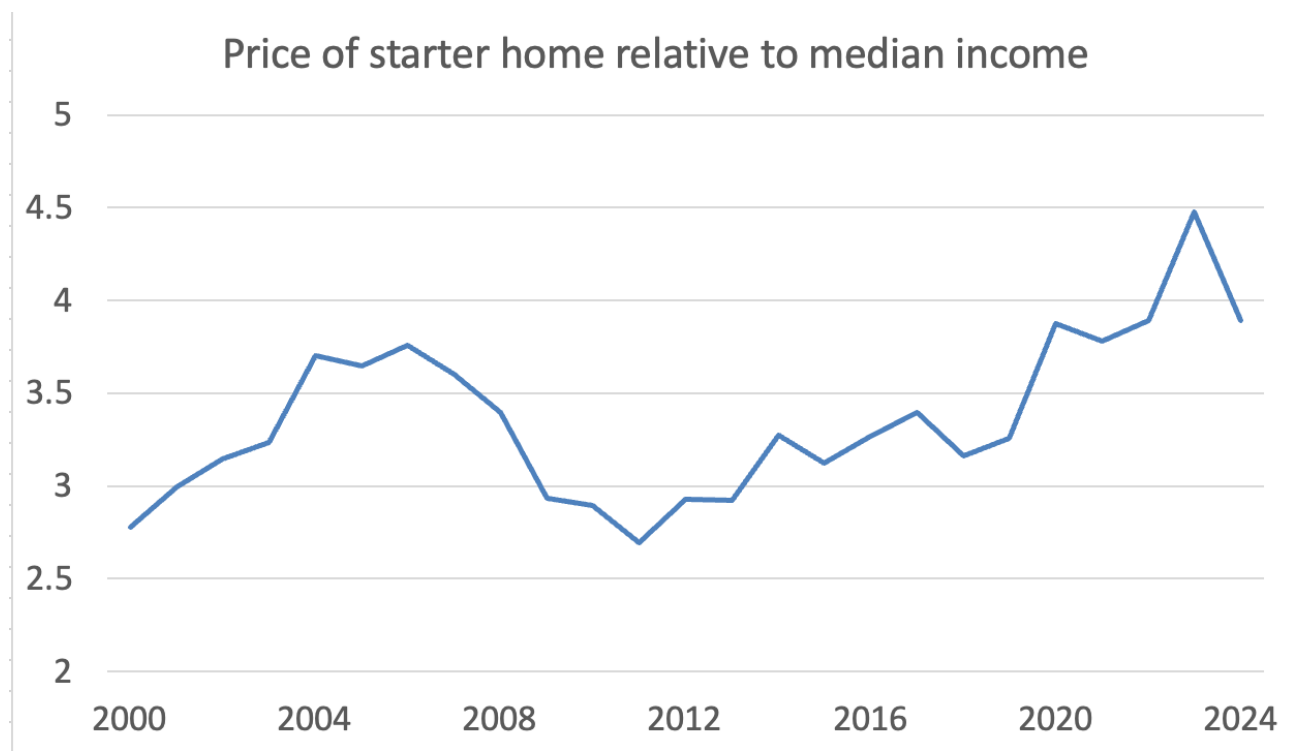
The unaffordability of houses

Owning your own home has long been part of the American Dream. One can argue that it shouldn’t be, that people can live rich, fulfilling lives in rented apartments. Hey, I know some of those people! But then, New York is very atypical in that respect. And as always, good luck telling people that they should feel differently than they do.

The fact is that in most of America owning a house is a crucial element of perceived well-being. As I'll explain next week, the ability to buy a house is closely tied to social inclusion, and being unable to do so has serious negative effects on behavior.

And while most Americans have seen their incomes more than keep up with the overall cost of living, incomes have *not* kept up with home prices. This is especially relevant to Gen Z, many of whose members are at the point in their lives when, by traditional cultural norms, they should be buying their first houses but can't come up with the down payments.

Here's the ratio of the average cost of a starter home, according to the National Association of Realtors, to the median income of households aged 25-34:



Source: National Association of Realtors via Haver Analytics, Census

You can clearly see the rise and fall of the 2000s housing bubble, but underneath those wobbles is a clear, large upward trend in the price of houses compared with incomes. So the perception by many young Americans that home ownership has

become unaffordable and moved out of reach is grounded in reality: for many, just coming up with a downpayment is effectively impossible.

Affordability: A complex issue

To summarize where we are so far: The standard affordability narrative, of Americans impoverished because inflation has outstripped wages, isn't correct: most American workers have seen their real incomes rise. Yet this doesn't mean that working families are doing OK. Borrowing costs are up. Jobs are hard to find. And one crucial aspect of affordability, the ability of young Americans to buy their first houses, has deteriorated substantially.

My next primer will address affordability from a broader perspective, focusing on economic inclusion, financial security, and fairness. Check in (on these issues) next Sunday. And check in the following week for an affordability agenda for the Democrats.