

The Resilient and Adapting Economy

AN ESSAY BY BETSEY STEVENSON (NOVEMBER 2023)

Both GDP and the labor market have proven to be more resilient over the past 12 months than many predicted. By the end of 2022, anxiety over a potential recession was rising rapidly and continued to accelerate in 2023. In October 2022, a Bloomberg headline declared “Forecast for US Recession Within Year Hits 100%” and went on to declare that a recession was “effectively certain in the next 12 months.”

Since that declaration, the U.S. economy has added nearly 3 million new jobs and real GDP has grown by 2.7 percent. Not only was there no recession, but the economy has outperformed expectations at almost every turn. In September 2022, the Federal Open Market Committee projections were for the U.S. economy to grow by 0.2 percent in 2022 and 1.2 percent in 2023. A year later real GDP was estimated to have grown 1.9 percent in 2022 and Fed projections for growth in 2023 had been revised up to 2.1 percent above the Fed’s forecast for long-run real growth of 1.8 percent. Professional forecasters showed similar patterns of under-estimating U.S. growth in 2023 as the year began. At the start of 2023, the Bloomberg consensus was that economic growth in 2023 would be below 1%.

Employment has grown sharply and is now back to the pre-pandemic employment growth trendline. Unemployment has remained exceptionally low. In the 21st century, the unemployment rate has averaged 5.8%. In 2022, the unemployment rate was 3.6%. The last time the annual unemployment rate was lower was in 1969. In the first 10

months of 2023 it has also averaged 3.6%. While it has ticked up in the second half of the year, it remains below 4%.

The number of jobs available as indicated by data on job openings has come down since peaking in March 2022. At the peak, there were twice as many job openings as there was prior to the pandemic. As of September 2023, there were 9.6 million job openings compared to 7.2 million in September 2019.

Despite ongoing elevated numbers of job openings, hiring has returned to pre-pandemic levels.⁹⁷ The slowdown in hires and the ticking up of the unemployment rate indicate that the labor market is slowing slightly.

One of the big questions last year was whether workers would return to the labor market to fill these openings. The answer has been yes. Ultimately the Federal Reserve Open Market Committee will likely be credited with steering us toward a soft landing—bringing down inflation without causing a recession. However, this was clearly a worker and consumer driven boom. Workers entered the labor market to fill job openings, demanding wage increases that were sufficient to generate wage compression but did not generate a wage-price spiral.

Consumer spending has remained above trend despite the Fed’s efforts to raise interest rates to reduce demand. New business formation surged in 2022 and has continued well into 2023. Ongoing consumer spending, and perhaps the surge in business formation as well, has been helped by

⁹⁷ The Bureau of Labor Statistics Job Openings and Labor Turnover Survey began in 2000.

household's strong balance sheets and the moratorium on student debt. Inflation adjusted median net-worth jumped in 2022 compared to 2019 by more than any other three-year period since the Federal Reserve began its comprehensive survey of consumer finances more than thirty years ago.

But not everything is rosy: the challenge has been rising prices. Inflation peaked at 9% in June 2022 and has subsequently fallen to 3.2% as of October 2023. While current inflation is within normal rates, the brief period of high inflation has sparked economic anger and frustration.

In short, we began the year with many predicting a recession, and yet we are ending the year with unemployment remaining near 50-year lows and GDP and employment growth that is above trend. While the economy is slowing, it is slowing toward the elusive soft landing in which inflation returns to the Fed's 2 percent target with unemployment staying low.

This essay explores our current economy and labor market, potential lessons about government support, and highlights challenges on the horizon. Many of the challenges pre-date the pandemic.

Household Balance Sheets and Government Support

The typical American has gotten a lot richer than they were prior to the pandemic. The Federal Reserve's comprehensive survey of consumer finances laid out gains in net-worth and family income, all while debt stayed low relative to the period before the pandemic. While those with the most education and the highest net worth saw the biggest gains in median income from 2019 to 2022, the increase in net worth was seen across the income distribution.

Much of the boost to balance sheets came from the support that the government offered families and businesses during the pandemic. This swelled the coffers of families throughout the income distribution. However, one group—student

loan holders—may have benefited the most. Interest was suspended in March 2020, and thus with zero interest, inflation eroded the value of the debt. Moreover, for those enrolled in an income-driven repayment plan, such as public service forgiveness, the more than three year moratorium counts toward their required period of payments before loans are forgiven.

But government support isn't the only reason that household wealth rose. The stock market and housing prices soared over this time period helping contribute to the nearly one-third increase in the average real value of families' financial assets.

Rising household wealth may offer a partial explanation as to why older Americans have not returned to the labor force to the same extent as younger workers. Among people ages 65 to 74, inflation-adjusted mean net worth rose 27%. The baby boomers were expected to keep working long past when previous generations retired, but the surge in wealth has allowed more of them to stay out of the labor force than expected.

Researchers will undoubtedly spend decades assessing the direct link between the forms of government support offered, the private sector response to the pandemic, global linkages, and the vibrant response of household spending and labor force participation. However, even now it is clear that supporting families and businesses during the worst days of the pandemic did not create a generation of people detached from the labor force. It contributed to a demand-led recovery that has proven to be much more resilient than past recoveries.

The high demand coming out of the pandemic was met by record-breaking growth in business formation. Applications for new businesses reached an all-time high in July 2020 and have remained historically elevated through mid-2023. The Federal Reserve's survey of consumer finances showed that in 2022, 1 in 5 families owned a privately held business,

the highest share on record. The expanded safety net and reduction in debt may have provided an incentive for Americans to take the risk of forming a new business.

Labor Force Participation

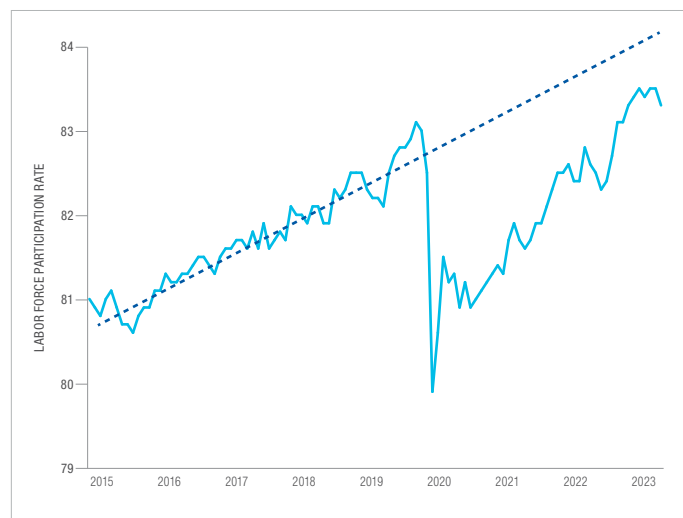
Labor force participation has recovered most strongly among prime age adults—those ages 25 to 54 (see Figure 1). A larger share of the prime age population is participating in the labor force and, with the low unemployment rate, a larger share are employed today than in 2019. However, the counterfactual of where would the labor market be today without the pandemic is challenging because it is unclear whether the upward growth in labor force participation that occurred between 2015 and 2019 would have continued. Measured against the 2015 to 2019 trend growth in labor force participation, prime age labor force participation remains below what that trend would have generated.

Prior to the pandemic prime age women’s labor force participation was growing much more strongly than that of men, rising by nearly 3 percentage points between 2015 and the end of 2019. While it has not kept up with that trend growth, it has surpassed the pre-pandemic peak and

has continued to narrow the gap with the trend line over the past year (see Figure 2). In contrast, prime age male labor force participation grew more slowly following the 2008 recession. While there was upward growth between 2015 and 2019, male labor force participation has never fully recovered from the 2008 recession. In February 2020 prime age male labor force participation was 89.2%, well below the January 2008 rate of 91.1%.

Figure 1: Prime Age Labor Force Participation

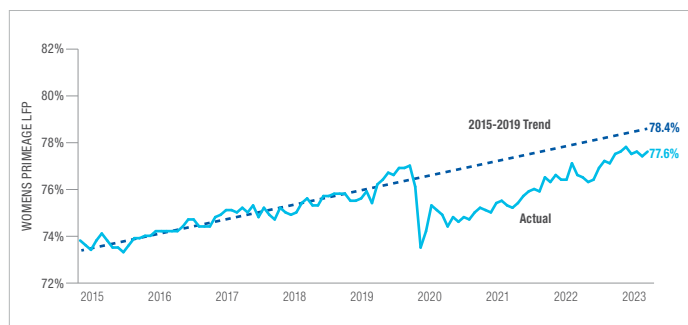
Share of population ages 25-54 either working or looking for work



Seasonally adjusted data.
Source: Bureau of Labor Statistics. Created with Datawrapper.

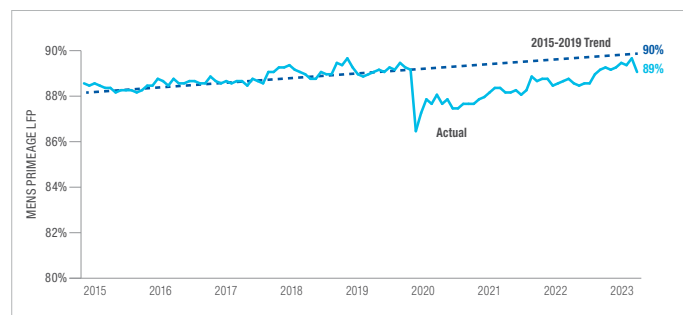
Figure 2: Prime Age Labor Force Participation Rate vs Prior Trend

Share of women ages 25-54 who are working or looking for work



Seasonally adjusted data
Source: Bureau of Labor Statistics. Created with Datawrapper.

Share of men ages 25-54 who are working or looking for work



Seasonally adjusted data
Source: Bureau of Labor Statistics. Created with Datawrapper.

In the current recovery, prime age male labor force participation has been at or above the February 2020 rate for much of 2023 but fell below it in October.

That female labor force participation continues to grow to new record highs, while male labor force participation struggles to recover points to both a place for optimism and a place for concern. The labor market and the economy more generally has left many men behind as it has evolved. Lower educated men have had some of the largest declines in labor force participation over time. There is a large literature examining this trend and many have argued that declining participation has been at least somewhat explained by declining labor demand, particularly among low-skill and middle-skill workers.⁹⁸

The surge in labor force participation was essential to ensure that the economy could bring down inflation while keeping unemployment low. Workers' supply response to the

tight labor market ensured that there was not inflationary competition over a fixed supply of workers. Beyond helping the economy achieve a soft landing from the high inflation, the experience of the labor market in the post-pandemic era suggests that a tight labor market may be essential for the U.S. to operate at its true potential, involving a large and growing share of people in the economy.

Stepping back and examining at all adults, labor force participation remains below that of the fourth quarter of 2019, largely reflecting the ongoing aging of the population and the slow recovery of labor force participation among older adults (see Figure 3). As noted above, labor force participation among those over age 65 has failed to recover following the covid pandemic drop. However, in the second half of 2023, labor force participation grew strongly for those ages 55 to 64, particularly among women whose labor force participation hit a record high. Prior to the pandemic labor force participation was rising among older adults,

Figure 3: Labor Force Participation Oct. 2023 vs. 4th Quarter 2019

Share of population working or looking for work

Overall and By Gender		October 2023 – 4th Quarter 2019				
Overall		62.7% < 63.3%				
Men		67.9% < 69.2%				
Women		57.6% < 57.7%				
		40.0%	50.0%	60.0%	70.0%	80.0%
By Race/Ethnicity						
Black		62.7% < 62.9%				
White		62.3% < 63.2%				
Hispanic		66.9% < 67.4%				
		40.0%	50.0%	60.0%	70.0%	80.0%
By Education (Ages 25+)						
HS, No College		56.9% < 58.0%				
Some College		62.3% < 64.6%				
Bachelors +		72.8% < 73.9%				
		40.0%	50.0%	60.0%	70.0%	80.0%
By Age						
Ages 16-19		35.8% > 37.9%				
Ages 20-24		70.8% < 71.8%				
Ages 25-54		82.8% > 83.3%				
Ages 55+		38.6% < 40.3%				
		40.0%	50.0%	60.0%	70.0%	80.0%

Seasonally adjusted data. Ages 16+ except where otherwise noted
 Source: Bureau of Labor Statistics. Created with Datawrapper.

⁹⁸ Aaronson, S., Cajner, T., Fallick, B., Galbis-Reig, F., Smith, C., & Wascher, W. (2014). Labor Force Participation: Recent Developments and Future Prospects. *Brookings Papers on Economic Activity*, 197–255. <http://www.jstor.org/stable/43233868>.

particularly among those with more education. While the pandemic undoubtedly had a permanent impact on narrow cohorts of older Americans who retired early into the pandemic, the post-pandemic boom may help keep older Americans in the labor force in the coming years.

As with prime age adults, among all adults, male labor force participation has been weaker than that of women. Women's labor force participation in October 2023 is roughly the same as that in the fourth quarter of 2019. In contrast, male labor force participation is 1.3 percentage points lower.

Turning to race, the labor force participation rate among black workers is slightly higher to that prior to the pandemic, while it has fallen by a percentage point among white workers. Labor force participation rates among Hispanic workers have fallen by half a percentage point.

Black employment has recovered much more robustly than employment among whites. While long-standing gaps remain in the labor force participation rates of prime age workers by race in the post-pandemic labor market, this convergence in employment rates is notable. Between August 2022 and July 2023 an average of 77.3% of prime aged Black people were employed, more than any other 12-month period on record.

The recovery among Black workers is particularly notable because they were more likely to get laid off during the pandemic because of their disproportionate employment in the in-person service industries and the early months of the pandemic harmed Black workers with COVID-19 outcomes

far worse than for whites. The strong improvements for Black workers illustrates how tight labor markets can have larger impacts on some groups of workers.

This greater improvement in labor force participation has occurred at a time of increased wage compression, with more rapid wage growth going to lower wage workers relative to higher wage workers.⁹⁹ Autor et al. find that this compression counteracted nearly 40% of the increase in the growth in the 90-10 log wage inequality. Black workers are disproportionately employed in low-wage occupations, as such they benefited disproportionately from the wage compression.¹⁰⁰ Autor et al.'s analysis finds an important role for the surge in labor market dynamism including record high quit rates in explaining which workers experienced the most real wage growth.

Research following previous recessions has found that displacement from jobs during recessions can have lifelong impacts on people's careers. The pandemic recession differed from previous recessions in two important ways. The first was that job loss was concentrated in the high-turn over service sector. The second was that the post-pandemic period was a time of record dynamism in the U.S. economy both in terms of business formation and job churning. Many of the workers who lost their jobs during the pandemic have found for job and wage improvements through the transition.

Unions and Labor Actions in 2023

Workers have come out of the pandemic with more bargaining power than they have had in decades. This fueled wage growth for workers willing to change jobs and change

⁹⁹ David Autor, Arindrajit Dube & Annie McGrew, "The Unexpected Compression: Competition at Work in the Low Wage Labor Market" NBER Working Paper 31010, November 2023.

¹⁰⁰See Figure 17 of Autor, et al.

employers, as seen in the research on the reduction in wage inequality. But for workers with fewer opportunities to take their labor elsewhere, wages were more likely to stagnate.

Strikes and labor actions are up by more than 50% in 2022 and are on track to be even higher in 2023.¹⁰¹ One reason for these labor actions is that the wages of unionized workers did not keep up with those of non-unionized workers, reducing the union wage premium.¹⁰² For some unionized workers, like the UAW, their existing contract did not protect them from higher inflation. For example, the UAW signed a contract four years ago that gave up cost of living increases to get greater profit-sharing. This concession might have been a smart move in 2019, but it proved unlucky in light of post-pandemic inflation rates. Moreover, the UAW workers were still feeling the loss of what they had given up to save the auto industry during the Great Recession. The union chant of “record profits, record contracts” was a rallying cry that spoke to union workers and to the American public.

Unions faced a challenging situation at the start of 2023. Just 6.0 percent of private sector workers were unionized in 2022. A higher share of the public sector is unionized bringing the overall unionization rate in the U.S. economy to 10.1 percent. This unionization rate is an all-time low, down from nearly a third of all workers belonging to a union at the peak of union power in the 1950s. This low rate of unionization means that most workers have never and will never belong to a union.

The decline in the unionization rate is the result of a combination of policy, business, and economic changes. State legislatures passed “right to work” laws, while the Federal

government weakened national collective bargaining rules. Manufacturers shifted operations to “right to work” states and out of the country. And the economy through these decades grew primarily in the service sector, in industries that have not traditionally been the focus of unions.

On the other hand, Americans’ approval of labor unions remains near highs last seen in the mid-1960s after rising sharply from an all-time low in 2009.¹⁰³ Attitudes have shifted more favorably toward unions: 61% of Americans say that unions help the overall economy higher than at any other recorded time.¹⁰⁴ And when it comes to strikes, Americans tend to side with the workers. An August 2023 poll found that 3 out of 4 people side with the auto workers and more recent instant polls show continued strong support.

While some have argued that striking is indicative of high bargaining power, these labor actions are better described as the result of a rapidly changing economy in which there is a high degree of uncertainty. Over the past three years the labor market has gone through an extraordinary amount of upheaval. The number of people voluntarily leaving jobs and the number of people being hired each month has been above pre-pandemic levels for most of the past three years.

The ratio of the number of unemployed people to job openings has been elevated, but because most people taking open jobs are employed people trying to find a better job, this ratio is only useful in comparison to the past. Labor force participation has expanded more than most predicted and more people have changed jobs than in recent decades. The result is that this metric has provided almost no insight into how tight the labor market is in recent years. It surged as we recovered from the pandemic peaking in early 2022.

¹⁰¹ <https://www.ilr.cornell.edu/faculty-and-research/labor-action-tracker-2022> and <https://www.bls.gov/wsp/>.

¹⁰² <https://www.bls.gov/news.release/union2.t02.htm>.

¹⁰³ <https://news.gallup.com/poll/398303/approval-labor-unions-highest-point-1965.aspx>.

¹⁰⁴ <https://news.gallup.com/poll/510281/unions-strengthening.aspx>.

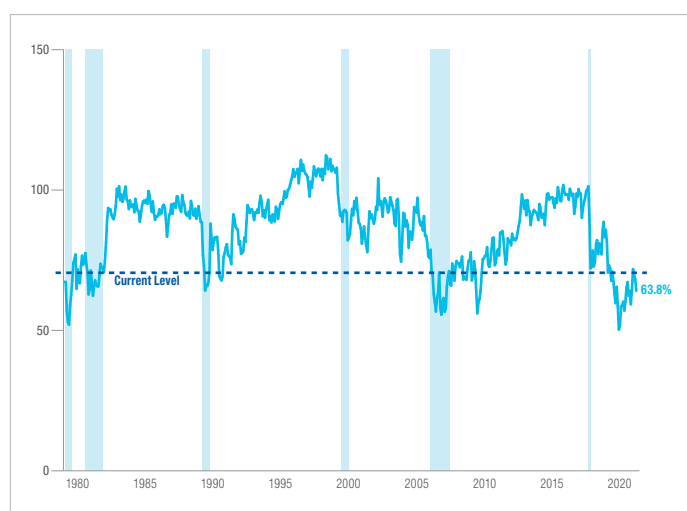
It has fallen substantially since then with little impact on unemployment or wages.

Low Consumer Sentiment

Americans are down on the U.S. economy, despite all of the economic good news. The Michigan survey of consumer confidence hit a low below that experienced at any point during the 2008 recession. It remains at levels typically only seen during recessions.

Figure 4: Consumer Confidence is at Recessionary Levels

University of Michigan consumer confidence index



Shaded areas show recessions.

Chart: @BetseyStevenson Source: University of Michigan. Created with Datawrapper.

Low consumer confidence combined with record high consumption spending has made consumer confidence a less useful metric of the state of the economy. Why are consumers spending so much if they are so down about the economy? Alternatively, why are consumers so down about the economy when they feel so confident to spend? One answer might be in the government support that was provided during the pandemic. Because consumers had excess savings they have been able to spend despite very real doubts about the strength of the economy.

Figure 5: Consumption Spending Remains Remarkably Strong (and Above the Pre-pandemic Trend)

Per capita consumption spending adjusted for inflation

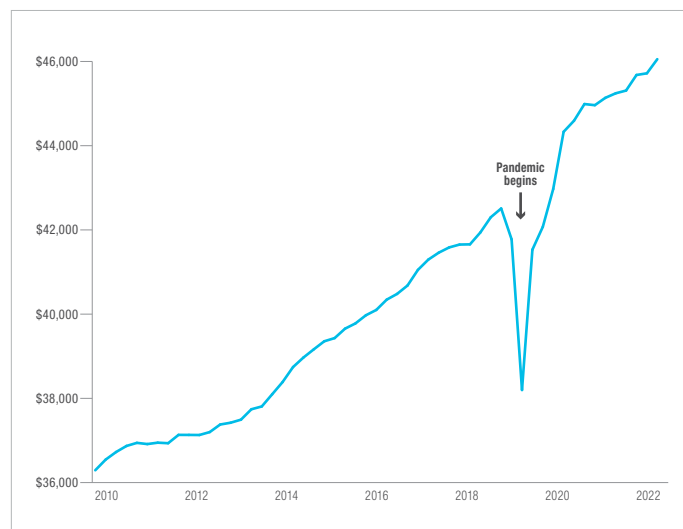


Chart: @BetseyStevenson. Source: Bureau of Economic Analysis. Created with Datawrapper.

Alternatively, this may simply be about money illusion. The income increases are letting them keep spending. Inflation is now down enough that there are no longer large redistributive impacts.

Bob Shiller found that people think that inflation impacts prices, making them worse off, but has little impact on their wages.¹⁰⁵ As he noted “people do not see the connection between inflation and increases in income that might be associated with it.” This kind of selective credit leads people to really hate inflation. It is arguably worse right now because inflation has inflated the price of assets like homes and the stock market. Yet, homeowners rarely blame inflation for the higher value of their homes and shareholders rarely blame inflation for the higher nominal values of their investment portfolios.

The result is that people struggle to get over price increases. A 2023 Gallup poll found that 35% of respondents said that inflation and the high cost of living was the most important

¹⁰⁵Shiller, Robert J. “Why Do People Dislike Inflation?” in Christina D. Romer and David H. Romer, eds., *Reducing Inflation: Motivation and Strategy*. Chap. 1. Chicago: University of Chicago Press, 1997, pp. 13-65.

financial problem that their family is facing. That compares to 6% of respondents in 2019. Even though the prices of many of the things households buy—like groceries—are largely unchanged from the beginning of 2023.

To be clear, the challenge is no longer inflation. While inflation remains above the Federal Reserve Board's target of 2 percent, the inflation rate is currently within historical norms. The 2023 third quarter inflation rate of 3.57% is below that in the last two quarters of 2005, the first two quarters of 2006, all of 2008, and the third quarter of 2011. The goal is to get the inflation rate as measured by the Consumer Price Index down about another percentage point, so that it is around 2.5%. Could people really be that upset about the economy because prices are rising 3.6% instead of by 2.5%?

The goal of setting inflation at 2 percent is that it is low enough to grease the wheels of the economy without being high enough to be noticeable. The rate of inflation we faced in 2022 was definitely high enough to be noticeable. The question is whether people are still noticing inflation because 3.6% inflation is too high to ignore or because they have yet to adjust to the higher level of prices.

A different explanation is that people are not angry about the economy right now, but instead they are angry about the economy of the 21st century. An economy that they see as unjust and rigged, serving a corrupt few at the expense of hard-working families. This sense that our economy is broken has contributed to our political polarization. The polling data show that Republicans are the most unhappy with the economy right now, even among those who say that their own economic situation is strong.

Some economists argue that it is the polls themselves that are broken. But I'm not so sure. Perhaps the polls are telling us something deeper about the broken trust people have in our institutions including the economy and our policy makers. People have been through the wringer over the past four years, and we came out of it with a better economy than when we entered it. But we entered with an economy that had stagnant wages for the middle class, unaffordable education and childcare, no guaranteed paid time off, and five decades of rising inequality.

Concluding Thoughts

This economic recovery has unique challenges from supply chain disruptions to a near-energy crisis related to Russia's invasion of Ukraine, to a war in the Middle East. But to put it in perspective, it took more than eight years for unemployment to fall below 4% following the 2008 recession. And yet, unemployment was below 4% by December 2021 less than two years following the pandemic-induced recession. Real GDP recovered to its 2019 fourth quarter level by the middle of 2021 and has exceeded most estimates of potential GDP for 2023.

The explanation for the ongoing strong recovery must lie with supply. Early in the pandemic, it was clear that worker illness and death, lower labor force participation, supply chain disruptions, and lower business investment had lowered potential GDP.¹⁰⁶ The question was how quickly it would recover. The answer is that the supply chain disruptions were temporary and have passed. Businesses became incredibly adaptable, with record high new business formation and rapid changes in how and where work is done.

¹⁰⁶Fernald, J., & Li, H. (2021). *The Impact of COVID on Potential Output*. Federal Reserve Bank of San Francisco Working Paper 2021-09. <https://doi.org/10.24148/wp2021-09>; Furman, J., & Powell, W. (2022, January 27). *The economy grew faster than expected in 2021, but the pandemic transformed its composition*. Peterson Institute for International Economics. <https://www.piie.com/blogs/realtime-economic-issues-watch/us-economy-grew-faster-expected-2021-pandemic-transformed-its>.

It is too soon to do a post-mortem analysis of the fiscal and monetary policy response to the pandemic and its aftermath. While inflation has fallen from 9 percent to 3 percent, the final stages of reducing inflation to the Federal Reserve Board's target of 2 percent could prove particularly challenging. Yet, at this point it is clear that the economic recovery was initially (and perhaps too strongly) fueled by record high government spending. The fears that workers would be kept out of the labor force by unemployment insurance that completely replaced wages proved to be, if anything, temporary. Labor force participation in 2023 was higher for many groups of workers than it was in 2019. The many government programs that reduced debt and provided income to households allowed a demand-fueled recovery.

A year ago it was clear that GDP had fully recovered, but employment was still lagging pre-existing trends. The past 12 months of strong and unexpected labor growth has led to labor force participation rates that have surpassed the pre-existing levels of participation and are nearing the growth trends seen between 2015 and 2019. Low unemployment and rising labor force participation has happened in a labor market undergoing an extraordinary amount of upheaval.

All of the dynamism in the U.S. economy suggests a robust economy, but the changes of the past fifty years continue to drag on consumer sentiment and ultimately on the potential for the overall economy. Despite record high job growth, rising real wages, historic increases in wealth throughout the income distribution, and low debt burden, most Americans think that they are financially worse off. One poll found that only 14% of US voters believe that they are better off than they were in 2020 (before Joe Biden became President).¹⁰⁷

A year ago *Foreign Policy* called for leaders at Davos to “start taking the public’s declining faith in institutions seriously—or face more upheaval to come.” This ominous warning came from decades of declining trust in institutions and interpersonal trust that has fostered partisanship, protests, and uprisings. *Foreign Policy* linked the discontent to the continued spread of populism, anti-capitalist sentiment, and the backlash against trade. They cited survey findings from the Edelman Trust Barometer, which surveys people across 28 countries and found that less than 20 percent of people trust the current system and 73 percent supported a change in the current system of global capitalism.

Trust is intricately linked to economic development—both facilitating economic growth and being shaped by economic growth. Higher trust in institutions leads to greater investment and economic activity because when people trust institutions to be effective, honest, and accountable, they are more likely to make long-term investments and engage in cooperative behavior. When governments are seen to be “exclusive” or “exploitative”, perhaps due to an unequal distribution of power, economic stagnation or decline occurs.

Our current economy illustrates both how we can create a more inclusive economy and the need to do so in a way that builds public trust and cohesion. While much of the consumer anger sparked in the past year may be focused on high prices, its roots go deeper into our economic system. To succeed in the coming decades we will need to address the big challenges presented by global warming, rapid technological change, and an aging population in advanced economies. These problems will be impossible to address without rebuilding trust and confidence in government and the economy.

¹⁰⁷<https://www.ft.com/content/c17c35a3-e030-4e3b-9f49-c6bdf7d3da7f>.