ECONOMIC INNOVATION GROUP

The American Worker Project

American workers are doing great. They could be doing even better.

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Editor's note: This is one of a pair of essays responding to the Economic Innovation Group's report, "The American Worker: Toward a New Consensus", by Adam Ozimek, John Lettieri, and Benjamin Glasner. The other is by Paul Krugman of the New York Times.

To the Economic Innovation Group's attempt to articulate a "new consensus" about the American worker, I'd respond in three words: I enthusiastically agree. I would articulate that consensus as follows: American workers are doing great. But we should not be satisfied. Workers could be doing even better, and policymakers should have improving economic outcomes for workers as one of their top goals.

EIG articulates their hoped-for new consensus similarly. "Simply put," they write, "the American worker is doing better than at any time on record across a vast array of important measures." "And yet... Decades of cumulative gains mask a troubling downshift in the pace of progress." Later in this essay, I will quibble with their characterization of the trend. But regardless, EIG and I arrive at the same conclusion: "The progress is real and undeniable. So too is the unfulfilled potential."

EIG is on uncontroversial ground with their conclusion that things could be (even) better for typical workers and households. This, then, would mark a "new" consensus if agreement that workers are doing well were more widely shared. Getting agreement on that point is a tall order.

EIG writes that "many will be surprised" by their view that "the American worker is doing better than at any time on record". That is an understatement. Politicians from both parties enthusiastically declare that life was better in the past and that the economic system is rigged against typical workers. In their academic papers, many economists simply assume that wages have been stagnant for decades. And economists, public intellectuals, and business and opinion leaders are often at odds with EIG's reading of the evidence on workers' outcomes.

Why all the pessimism? Let me offer four reasons.

The first is the nature of politics: You don't win an election by telling voters that things are great. Aspiring officeholders want to be change candidates, and our hyper-political culture is heavily shaped by political discourse.

The second is human nature—the headline "plane lands safely" won't sell newspapers.

The third reason is that many of the participants in the public debate were working professionals at a time when pessimism about the economic outcomes of typical workers was the empirically supported stance.

In November 1992, the average real hourly wage (in 2024 dollars) for nonsupervisory workers was $20.86. In November 1982, it was $21.53. In November 1972, it was $22.78. After accounting for inflation, wages for typical workers really had stagnated or declined for two decades during the 1970s and 1980s. So during the 1992 presidential campaign, when Clinton-campaign strategist James Carville quipped, "it's the economy, stupid," he was on solid empirical ground. Average real wages began growing in the mid-1990s, but it wasn't until the late 1990s that they recovered their 1970s- and 1980s-era losses.[1]

Finally, the economic trauma of the 2008 global financial crisis, Great Recession, and sluggish recovery that followed is a crucial driver of the current pessimism about the outcomes of typical workers.

The real median wage fell following the onset of the financial crisis, and did not recover its 2007 level until 2014. In other words, had the expansion ended in 2014, real wages at the median would not have recovered despite five years of economic growth.[2] Indeed, the severity of the downturn and the slow recovery not only help to explain pessimism about the state of American workers—they help to explain the rise of populist politics in both U.S. political parties (and throughout Europe).

Note that I do not include inequality on my list of pessimism drivers. For one, broad income inequality was stagnant or declining over this period. The nonpartisan Congressional Budget Office (CBO) applies a widely used measure of inequality (the "Gini coefficient") to household income after adjusting for taxes and transfers.[3] According to the CBO numbers, inequality fell by 6.6 percent from 2007–2016. From 2007–2020, the last year for which CBO's statistics are available, inequality fell by 8.4 percent. Rising inequality cannot explain the prevalence of pessimism if inequality was not, in fact, rising.

Given all the attention paid to inequality, this may seem counterintuitive. But consider the following: If the government had seized 10 percent of the income of the top 10 percent over the years immediately following the financial crisis, threw it in a ditch, and set it on fire, then income inequality would have decreased—and the bad stretch endured by typical workers would have remained.

In fact, concern about inequality and measured inequality do not seem to be correlated. During the 1990s, for example, the share of respondents to opinion polls who expressed concern that inequality was getting worse decreased. But over those years, measured inequality was increasing. Similarly, in the years following the financial crisis, concern about inequality growth increased, while measured inequality stagnated or declined.[4]

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[1] EIG's report has an excellent discussion of these trends. See also my book, *The American Dream Is Not Dead: (But Populism Could Kill It)*, for a detailed discussion of the trends and an expansion of my argument.

[2] For more detail, see Jay C. Shambaugh and Michael R. Strain, "The Recovery From The Great Recession: A Long, Evolving Expansion," *ANNALS of the American Academy of Political and Social Science*, vol. 695, no. 1, 2021.

[3] Congressional Budget Office, "The Distribution of Household Income in 2020," November 14, 2023.

[4] For more detail, see *The American Dream Is Not Dead*.

How to explain this? Wage growth is likely a more important factor behind people's views about inequality than the measured size of the rich-poor gap. Average wages were growing during the 1990s, so the perception that inequality was growing declined. The fact that wages were growing faster at the top than at the bottom was less salient and, therefore, less relevant. In the same way, in the years following the 2008 financial crisis, the median wage fell. Despite the fact that inequality fell as well, people perceived the rich-poor gap as growing.

That much of the pessimism is rooted in specific stretches of time when workers were not gaining ground—the 1970s and 1980s; the years following the 2008 financial crisis—is itself an argument that assessing the state of American workers requires some nuance. It is not enough to say "wages have been growing over the past half century", just as it is not enough to say—as many economists, public intellectuals, opinion leaders, and politicians so often do—that "wages have been stagnant over the past half century".

EIG admirably recognizes this. After reporting that median real wages grew by 35.9 percent from 1980 to 2023, EIG observes that "wage stagnation is long over and most workers missed it". They write: "The period of meaningful-but-lackluster wage growth since 1980 is actually better understood as two distinct periods that featured sharply differing outcomes for the typical worker." By their calculations, median wages grew by 38 percent from 1994 to 2023.

Moreover, they find that the median real wage for men and women were each trending up from 1994 to 2023, with the median male wage growing by 31 percent and the median female wage growing by 45 percent. Male wages are doing much better than the public debate would have you think.

This brings me to a quibble. EIG uses 1980 as the starting year of its analysis. Admirably, they take this choice seriously, pointing out that the vast majority of today's workers entered the labor force after 1980. But while 1980 is a reasonable year to start their analysis, I would have preferred a later starting point.

In my own work, I use 1990—July 1990, specifically—as the starting point for computing wage trends for the following reasons.[5] July 1990 was a business cycle peak, so comparisons to today's economy are "hot economy to hot economy" comparisons. As EIG notes, in the mid-1990s, the period of wage stagnation gave way to a period of wage growth. Comparing the behavior of wages under two different structural economic regimes results in muddled analysis.

Finally, 1990 was 34 years ago. Thirty-four years may be preferable to 44 years for two reasons. First, the further back you go, the harder it is to accurately adjust for inflation. Second, when opinion leaders argue that wages have been stagnant for decades, people hear that as referring to the wages of current workers. Reasonable people can disagree, but 44 years seems too long ago for the purpose of the public debate. As EIG notes, today's median worker is 41 years old, and more than two-thirds of workers today entered the labor market after 1993.

A second quibble. The EIG report correctly argues that a divergence between the growth of aggregate productivity and median compensation is not evidence that productivity has been less relevant to wages.

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[5] For more detail, see Michael R. Strain, "Have Wages Stagnated for Decades in the U.S.?" *Obserwator Finansowy*, June 27, 2022 and *The American Dream Is Not Dead*.

"Instead," the authors write, "the gap suggests that productivity growth itself, in addition to being too slow, is not being broadly distributed throughout industries and the labor market."

The policy debate attempts to infer too much from the correlation of these two time series. The fundamental economic and policy question is whether changes in the productivity of a demographic group affect the compensation of the same demographic group, not whether changes in aggregate productivity are related to changes in the compensation of a particular group of workers. Now, I agree with EIG's statement that "productivity inequality" across firms and industries is likely increasing over time. But the graph they show offers the reader little support for that view.

EIG argues—entirely correctly, in my view—that we should not be satisfied with the pace of progress. They point to "three core priorities that can form the basis of a new consensus agenda: faster and more broadly distributed productivity growth, persistently tight labor markets, and housing abundance".

The authors are quite right to argue for policies to increase housing supply, though I would not give it pride of place as one of three core priorities. To boost productivity, they argue for greater diffusion of productivity-enhancing knowledge, removing barriers to worker mobility by rolling back noncompete agreement and occupational licensing regulation, and increasing entrepreneurship by lightening the regulatory burden to starting a new business.

How couldn't you agree with the goal of faster productivity growth? Productivity is the key determinant of long-term living standards. Because I agree with this goal, I would add to EIG's list:

- More public funding for basic research, because research leads to technological innovation.
- Lower taxes on the returns to business investment, because investment fuels productivity growth and increases workers' wages.
- A large increase in high-skilled immigration, because high-skilled immigrants are engines of innovation and dynamism.
- More public investment in building human capital, especially through work-based training and fixing the nation's failing K–12 schools.

EIG is also right to highlight the importance of persistently tight labor markets. The best tool to increase upward mobility is a hot economy with tight labor markets, in which employers are chasing workers.

Beyond the relative scarcity of workers, sound macroeconomic policy is crucial. In the 20 years prior to the 1992 election, average nominal wages grew at a 5.1 percent annual rate. But inflation grew at a 5.6 percent annual rate, swamping those nominal wage gains. From November 1992 to the present, nominal wages have grown at a 3.3 percent annual rate while inflation has only grown at an annual rate of 2.1 percent. What caused this regime change? A central bank that anchored inflation expectations and a federal government that, in the 1990s, took fiscal responsibility seriously.

I would add an additional priority to EIG's list: Boosting participation in economic life. Though the hot economy in the years prior to the pandemic saw participation trending up—and though the tight labor

market of recent years saw participation exceed its pre-pandemic level—it is still the case that participation among prime-age adults peaked two and a half decades ago. Reforming safety net programs that discourage work and increasing earnings subsidies that encourage work are among the policies that could increase participation, along with faster productivity growth and sound fiscal and monetary policy.

Under Presidents Trump and Biden, the center of gravity of the policy debate has moved some distance from these priorities and policies. Irresponsible fiscal policy, trade and subsidy wars, and industrial policy will hurt workers by increasing prices, eroding the purchasing power of wages, and slowing productivity growth. Trump's hostility to immigrants will dampen entrepreneurism and dynamism, as will Biden's regulatory hostility to economies of scale.

But the nationalism and populism of the Trump and Biden presidencies is not a permanent condition. Guided by EIG's principles, future governments can help to ensure that workers' outcomes improve at an even faster rate going forward than they have over the past three decades. And the fact that the last several decades did see meaningful improvement should give us all confidence that the future can be better than the past.

Progress is not an impossible dream. It is a typical reality.

Explore the Economic Innovation Group's American Worker Project here.