High-Wage Economy: How Sustained Public Investment Can Reverse Decades of Wage Stagnation

This is a transformative moment for the US economy.

Because of smart policy choices, jobs are returning more quickly than they usually do after recessions, and workers are experiencing long-needed wage gains. This will feel and be different from the last three recoveries—in 2007, 2001, and 1990—which started with slow and weak jobs numbers and growth. We are beginning this recovery with a boom like the one we most recently saw in the late 1990s, and we have the potential to go beyond what that boom accomplished.

If our recovery continues at this pace, we can create a better economy than we had before the pandemic: We can lock in and accelerate today's wage gains, reduce inequities, expand economic sectors, and reach full employment.

But there's no guarantee.

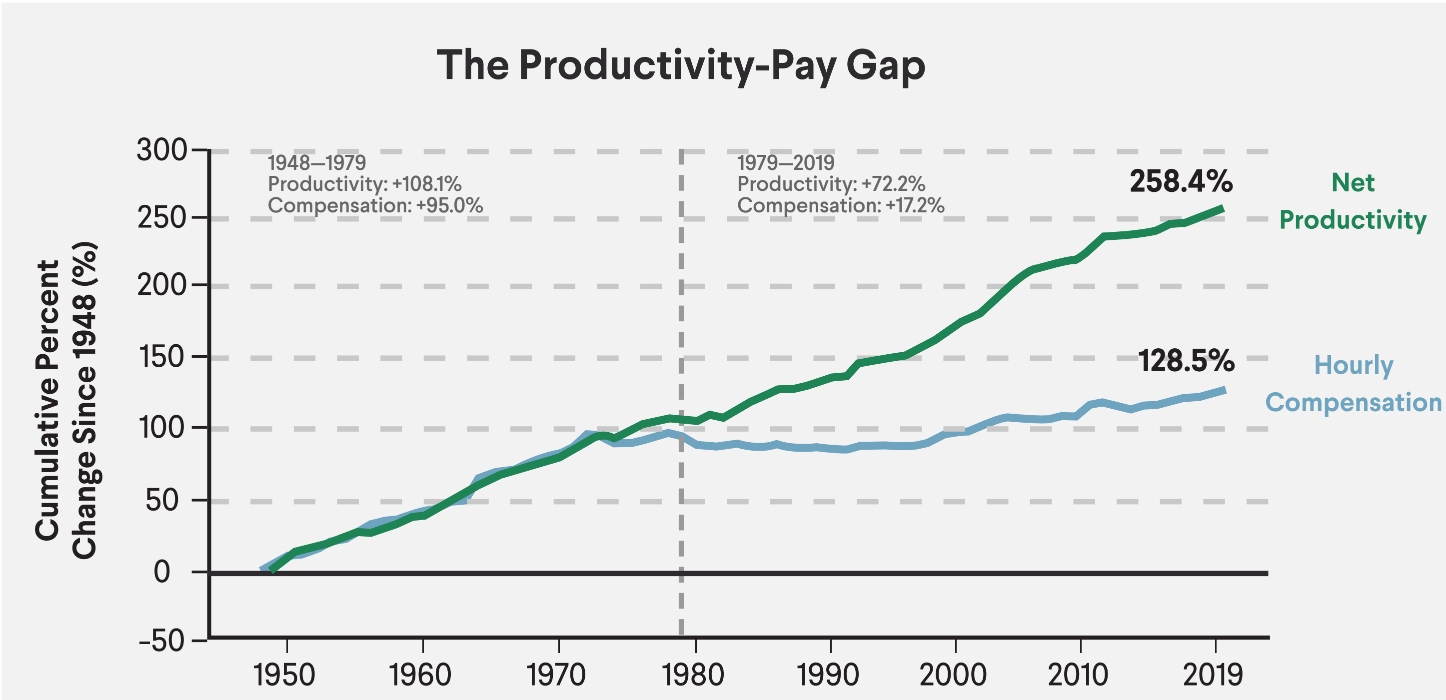
To ensure that today's boom lasts, and that it continues to benefit workers, policymakers must remember these three points:

- Today's rising wages are a direct and enormously positive consequence of the American Rescue Plan, reversing decades of wage stagnation for 70 percent of workers.
- Myths and misunderstandings about labor shortages and inflation shouldn't be a concern.
- To translate a temporary recovery into a permanent high-wage economy, government policy should defend the progress we have made and start investing more now.

Reversing decades of wage stagnation, the American Rescue Plan has had a direct and enormously positive effect on the rising wages we now see.

This year, wages have increased at a remarkable pace, up nearly 1.8 percent for nonsupervisory workers and 8.3 percent for leisure and hospitality workers since January 2021. This is a welcome change from decades of wage stagnation for most workers. While some of the recent wage gains reflect changes to who is employed, much of it is the result of the strong demand and enhanced worker bargaining power created by the $1.9 trillion American Rescue Plan.

Figure 1



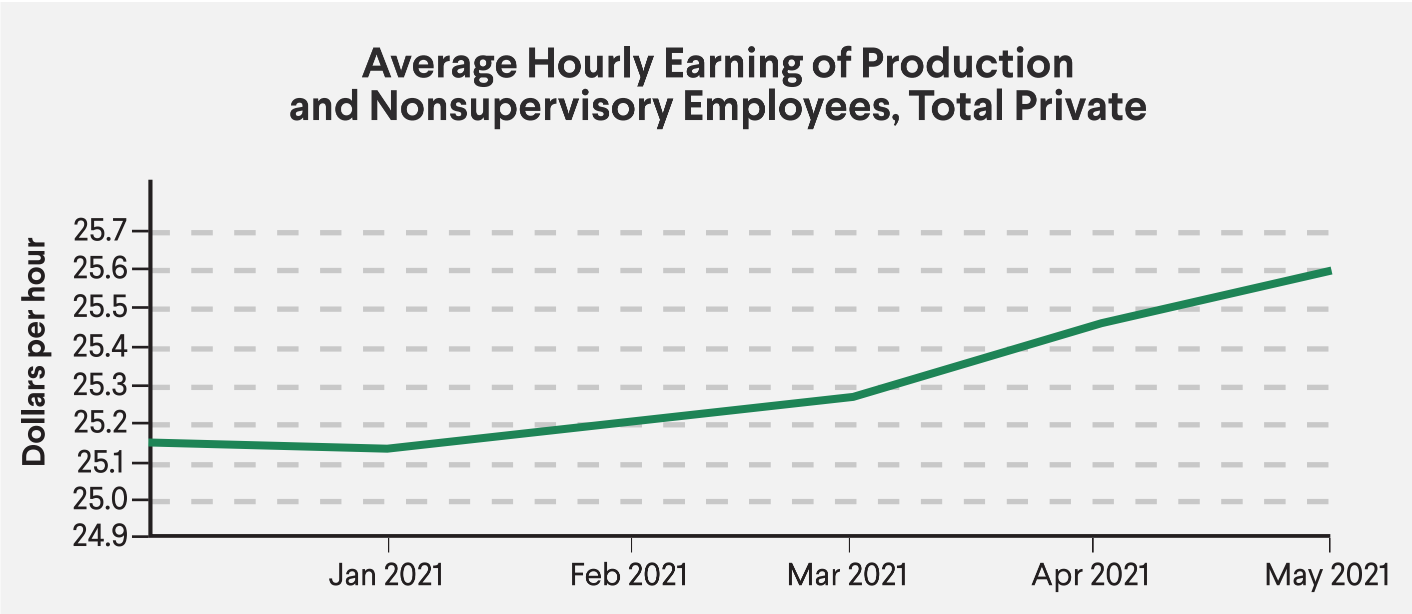
Source: Economic Policy Institute (EPI). https://www.epi.org/productivity-pay-gap/.

Since the 1970s, workers have had a rotten deal. Prior to the pandemic, despite a rise in the productivity of work, real wages had stagnated, disproportionately impacting low- and middle-income workers. In 2018, wages had about the same purchasing power as they did 40 years ago.

As the Economic Policy Institute finds in their review of productivity and wage trends from 1979 to 2019, productivity—or how much workers are producing—rose more than four times the rate of worker pay. During those 40 years, net productivity rose 72.2 percent, but real hourly pay rose only 17.2 percent—a small number compared to how much richer the economy as a whole became during that time. In other words, though workers were more productive than ever before, they weren't being paid for it.

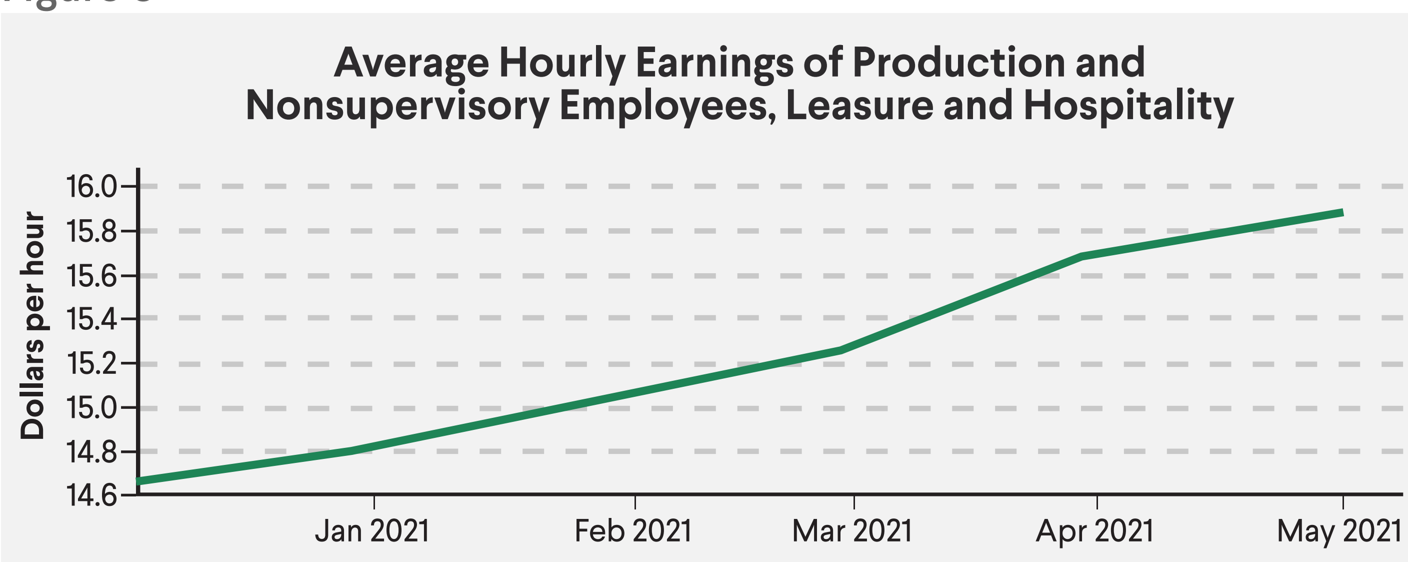
Rising productivity has the potential to turn into substantial and sustained wage growth for most workers, but in the last 40 years economic gains have largely accrued to top earners. Since the 1970s, wages for the bottom 70 percent of earners stagnated. But the top 10 percent saw their wages grow nearly 38 percent between 1979 and 2018, and the income share of the top 1 percent doubled over the last four decades.

Figure 2



Source: US Bureau of Labor Statistics. https://fred.stlouisfed.org/graph/?g=EK6v.

Figure 3



Source: US Bureau of Labor Statistics. https://fred.stlouisfed.org/graph/?g=EK6u.

The isolated moments of wage growth workers have experienced over the last several decades have occurred during periods of low unemployment and tight labor markets.

Notably, in the late 1990s—when unemployment was then at its lowest point since the 1960s—wages grew for a few years, before flatlining again in the early 2000s. We also saw some increases in wages in the period immediately prior to the pandemic. Between 2007 and 2017, real wage growth was larger than that seen in previous expansions.

Importantly, these gains occurred far into recoveries, and were overall insufficient to compensate for the loss of income and jobs that workers and families experienced during the 1990 and 2007 recessions. In the late 1990s, the upticks in wages came after seven years of recovery, and wage gains after the Great Recession came after 10 years of recovery efforts.

This time, it's different.

Because of proactive policy interventions like the American Rescue Plan, we are already seeing wage gains *much* quicker than we have during previous periods of recovery. Employment data from June 2021 show that average hourly earnings of nonsupervisory production workers is up 3.67 percent year-over-year.

With wages rising, workers benefit from higher take-home pay and stronger negotiating leverage—now and in the future. Higher wages set a floor that's difficult to reverse and can build a foundation for significant lifetime gains. Rising wages also directly reduce income inequalities, which have worsened in the US for much of the past four decades. Employers having to compete for workers on workers' terms leads to an overall shift in the balance of power.

Furthermore, rising wages can drive the economic growth we need to build back better. In an economy recovering from pandemic-induced weak demand, rising wages mean workers have more money to spend in the economy, which will facilitate further growth.

The American Rescue Plan created a backstop to the balance sheets of states, municipalities, and families to ensure they'd have the capacity to spend and keep demand high. And the extended unemployment insurance (UI) provided an essential lifeline for millions, while ensuring that workers had the power to demand higher wages and return safely to physical workplaces. These combined measures are helping provide the wage boost that workers desperately need.

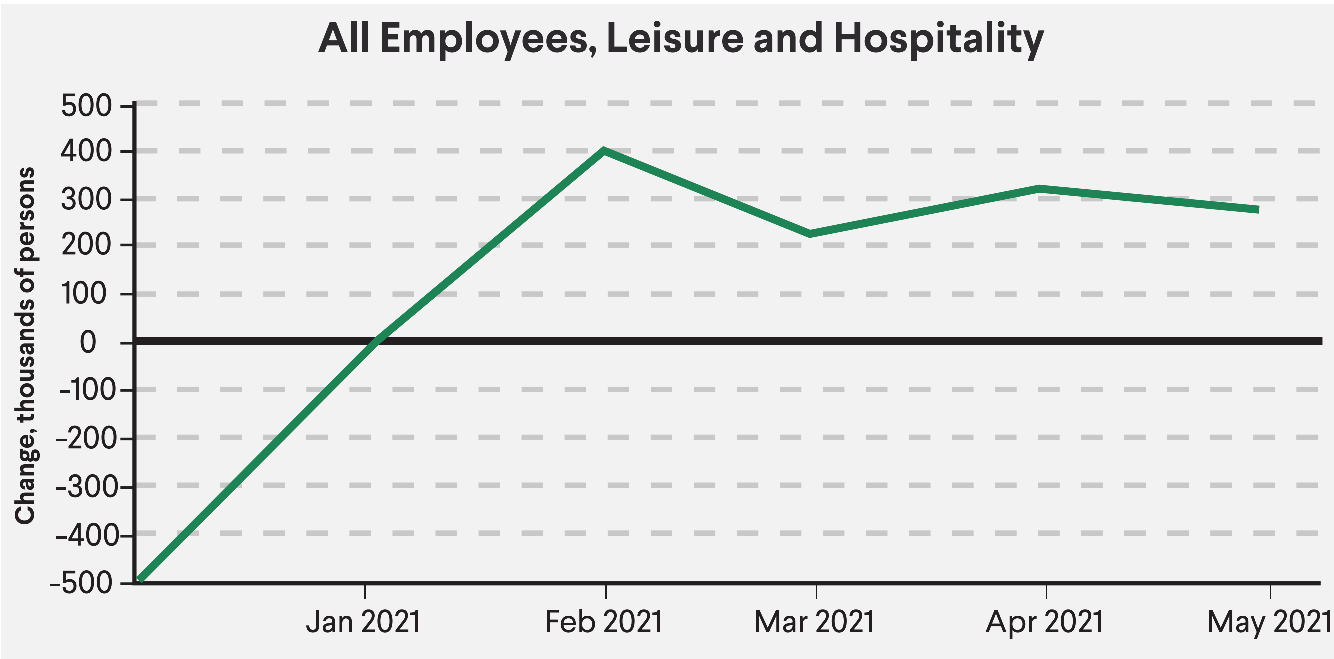
Myths and misunderstandings about labor shortages and inflation shouldn't be a concern.

Many unfounded and misleading concerns about the recovery are circulating. Two in particular stand out: that employers are facing a labor shortage of workers, and that inflation will overheat the economy and force a severe downturn. Upon closer examination, both concerns appear overblown.

Despite anecdotal reports that employers can't find workers because of expanded UI benefits, there is little evidence that the US is currently facing a labor shortage. Jobs numbers continue to be quite strong. Since February, the economy has added an average of 594,000 jobs a month—a rate unseen in any other recent recovery. This level of job creation is capable of getting us to the pre-COVID economy by the end of next year and of getting unemployment even lower than it was pre-COVID.

Restaurant and hospitality workers are going back to work. Job growth in leisure and hospitality has outpaced all other industries over the last several months. Since February, an average of 320,200 jobs have been created in leisure and hospitality each month, more than half of all net gains. The sectors that have had jobs number misses relative to predictions have not been at the low end of the income distribution, which is where we'd expect them to be if a flat-sum increase in unemployment insurance was causing people to not work.

Figure 4



Source: US Bureau of Labor Statistics. https://fred.stlouisfed.org/graph/?g=ELZs.

Fears of inflation and "overheating" have also been overblown.

Inflation statistics are being thrown off by several factors. Deflation a year ago makes a comparison between 2021 and 2020 misleading. Bottlenecks in select industries, such as used cars and lumber, have had an outsize effect on overall numbers. And some price increases are catching up in specific sectors—such as airlines—that have been particularly hard-hit by the pandemic and recession.

Removing those sectors that have been most severely affected by the pandemic would lower the level of inflation in the rest of the economy, which is where price changes would be a worrying sign for the health of the economy as a whole. Slowing down the recovery would not help these targeted and temporary blocks, and would unnecessarily harm the wage growth we've seen so far. What we need to address these blocks is more investment, carried out either by the private sector or the government. To the extent that supply constraints and rising prices are coming from specific bottlenecks that public action can address, those investments should be made.

We also need patience, as—with time—many of these bottlenecks and price changes will adjust themselves. We see the economy already rebounding in many of these key sectors. Lumber prices have fallen nearly 40 percent, and leading lumber companies are investing to expand capacity. This investment is precisely what can help sustain a boom and lead to a virtuous cycle of investment and productivity. As Federal Reserve Chair Jay Powell has stated, prices "that have moved up quickly because of the shortages and bottlenecks and the like, they should stop going up and at some point in some cases they should go down."

> **To translate a temporary recovery into a permanent high-wage economy, government should be investing more now.**

The economy is growing overall, with the OECD projecting growth of 6.9 percent this year, up from 6.5 percent in its previous estimate before the American Rescue Plan. The OECD estimates that the American Rescue Plan added between 3 and 4 percentage points to growth, a significant and important investment in our recovery.

In order to build on these successes so far, it is essential to make additional strategic public investments now, so we can ensure that the current boom lasts and that a well-paid workforce is ready to meet the moment. Though private investment will respond to sustained, strong demand, there are many cases in which more public investments will be necessary to complement the recovery.

When it comes to our labor force, investments in childcare and caregiving infrastructure would allow more parents and guardians, who frequently provide care as unpaid labor, to opt in to paid employment outside the home. And more investment in this area would also help raise wages for caregiving jobs, which are disproportionately held by Black and brown women. According to Lenore Palladino and Chirag Lala, investments in care infrastructure would create over 564,000 additional jobs and result in $82 billion dollars in wages annually. In addition to providing better economic security and choices for families, this care infrastructure would also help alleviate any actual labor shortages if they happen in future years.

Decarbonizing our economy is also essential. Action now would not only stave off climate catastrophe, but also the economic catastrophe that will follow uncontrolled temperature increases. One of the more comprehensive studies finds that warming of 4°C would yield economic damages of $23 trillion annually by 2100. Furthermore, the clean technologies and production processes innovated due to federal investments would create new, well-paying jobs that boost the economy for generations. According to estimates, investing in clean energy creates serious growth over time; a $320 billion-per-year investment would create 4.5 million jobs every year for the next 10 years.

This is a once-in-a-generation opportunity to raise wages for millions of people and set the US on a healthier, greener, and more inclusive economic trajectory. We can't afford to waste it.