ECONOMIC INNOVATION GROUP

The American Worker Project

The Tight 2020s

New opportunities, challenges, and options for the American worker

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Today's American worker faces a different kind of labor market than the labor markets of recent decades. Whereas job and wage increases were once scarce, job-seeking Americans now broadly participate in the workforce, and their bargaining power has grown because of the abundance of job opportunities now available to them.

The tightness of the current labor market has also delivered more egalitarian outcomes for workers, a stark contrast to the slack labor markets of the 2000s and much of the 2010s. Workers from racial and ethnic communities that had typically faced the brunt of recessionary shocks are now employed at increasingly similar rates to the general population. And workers earning the lowest wages have enjoyed the fastest wage gains.

If the primary challenge for American workers was once to find and keep a job, now the challenge is to ensure they are paid enough to keep pace with the rising cost of living**.** Inflation has been relatively high in recent years, and real (inflation-adjusted) compensation has therefore been weaker than in the years immediately before the pandemic—though notably stronger than in the aftermath of the Global Financial Crisis of 2008.

Inflation is now moderating. Should that trend continue, the current moment appears to be especially promising for the American worker.

The success of achieving a high-employment labor market is now translating into both nominal and real wage gains for all workers, proving that the final years of the 2010s were far from a fluke. Inflation-adjusted wages have now fully recovered—at least on some measures, and particularly for low-wage workers—from the cost of living shocks of 2021 and 2022.

And the rapid employment recovery from the Covid pandemic has given workers more and better chances to find and switch into jobs for which they are a good match, where they can do their best work—perhaps also putting the American worker on the cusp of a more sustained improvement in productivity and prosperity.

The broadening of employment prospects

The American worker is working.

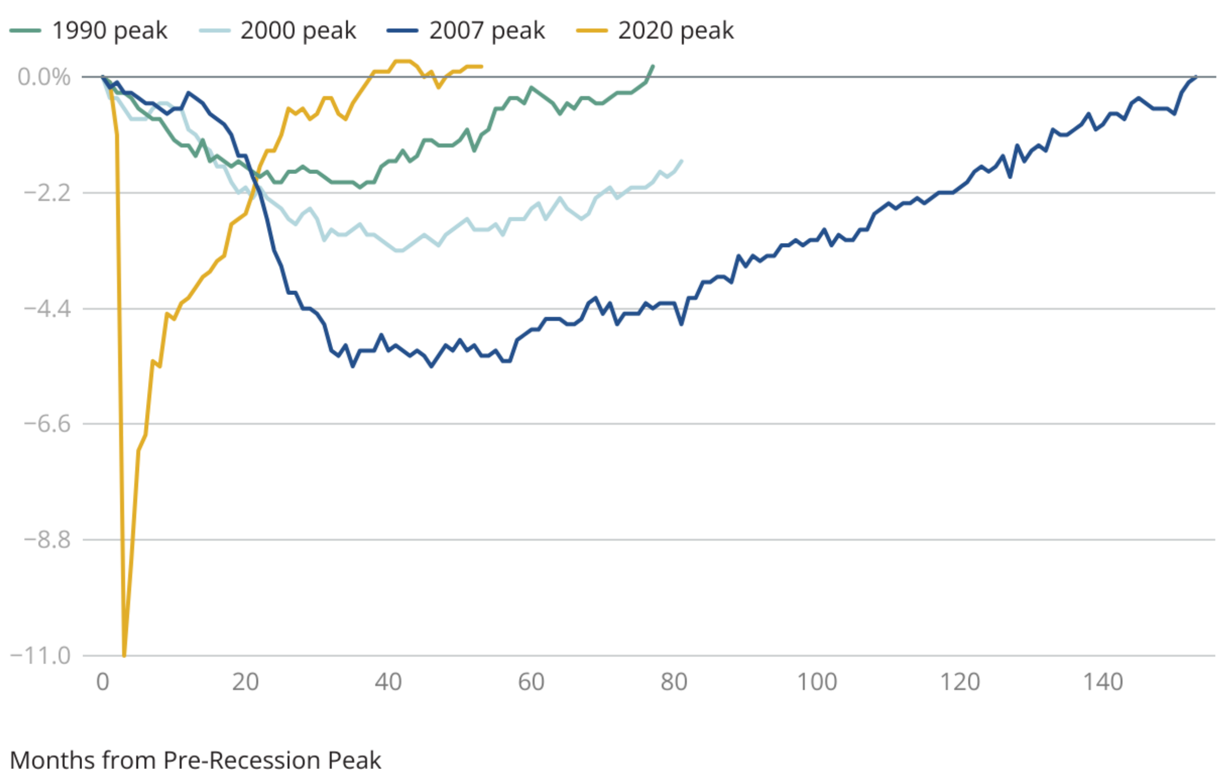
For much of the past few decades, such a claim would have been hard to support. Multi-year "jobless recoveries" followed each of the three recessions preceding 2020. The recovery from the Great Recession of 2008–09 was especially sluggish. Only in the final years of the 2010s—nearly a full decade after the recession ended—did we see a return to more meaningful levels of employment and signs of diffuse bargaining power for workers.

The recovery from the 2020 pandemic-induced recession was different. It was anything but jobless. Until June 2024, the unemployment rate had been 4 percent or lower for 28 consecutive months, a record not seen since the 1960s. (It climbed to above 4 percent in June.) More importantly, the unemployment rate has been broadly consistent with the low rates of unemployment that transpired in the two years prior to the 2020 recession.

Other, perhaps even better economic indicators[1] further confirm that the American worker has made great strides. The employment-to-population ratio for 25 to 54 year olds—workers of prime working age, outside of their schooling or retirement years—recovered especially quickly after the most recent recession.

Figure 1: A historically rapid recovery

Prime-age 25–54 employment rate (%) vs. Pre-recession peak



Source: U.S. Bureau of Labor Statistics

The speed of the recent employment recovery was far from guaranteed. The pandemic made the corresponding recession and recovery unique. The initial rebound in employment levels was indeed an unwind of temporary layoffs tied to spring 2020 emergency restrictions. But the number of American workers who reported permanent job losses continued to rise throughout 2020, ensuring that a substantial shortfall of employment remained at the beginning of 2021.

The more impressive phase of recovery began in the spring of 2021, demonstrating that recessions need not force a downward reset to employment trajectories. Growth in the time since was no longer just about the unwinding of the pandemic. By then, most American workers were not merely going back to the jobs they held before the pandemic. The shifting sectoral composition of employment—with some sectors hiring aggressively and successfully, and other sectors visibly lagging—makes that clear.

Vaccine availability (which addressed the risk aversion still lingering from the pandemic) and robust private sector balance sheets enabled an employment boom. Consumers had the capacity and willingness to spend, and businesses had the financial capacity to hire the requisite labor.

A consequence of the strong labor markets from right before and right after the 2020 recession was that a number of labor market inequalities have narrowed significantly. The mechanism is simple: As people get hired and labor grows more scarce, employers are incentivized to search harder and overcome their persistent biases.

Relative to the general population, unemployment rates for historically marginalized communities—which typically rise faster and remain more elevated following recessions—have converged to historically low levels.

Workers with lower levels of formal educational attainment see a similar pattern. In the tighter labor markets from just before and just after the 2020 recession, people without a bachelor's degree saw similar rates of employment to those with a bachelor's degree.

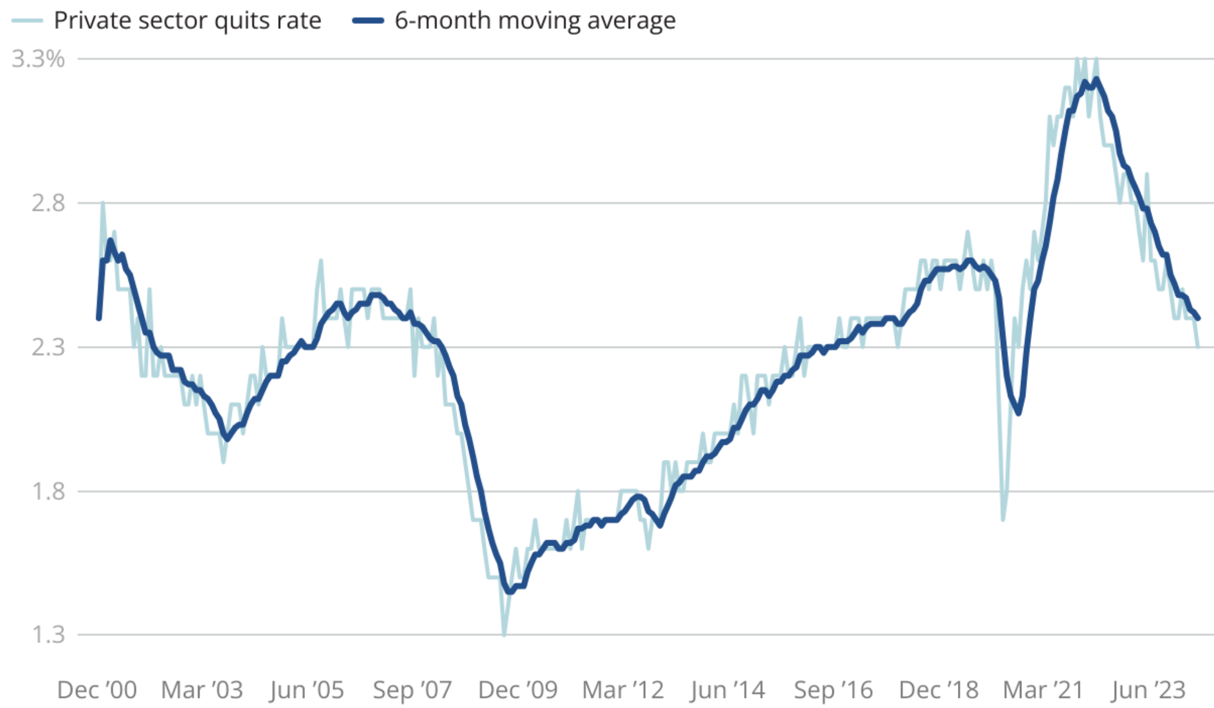
Net increases in employment are, on their own, a meaningful source of welfare improvement. For workers not previously earning a market income, gainful employment substantially transforms their capacity to consume and enjoy a better standard of living, independent of the precise level of compensation.

Growing bargaining power—but also growing pains

The rapid recovery in employment over the course of 2021 and early 2022 was not without costs and challenges along the way. Jobs were created at a pace that would match the peacetime transitions tied to World War II and the Korean War—but impressive as that might sound, all three of these episodes also involved historically high inflation.

As employers sought to recover pre-pandemic levels of staffing, aggressive labor demand translated into elevated job-switching from workers and one-time search costs for employers. Firms seeking to poach workers or hedge against higher turnover were incentivized to raise compensation rapidly.

Figure 2: Job-switching rates surged before falling and normalizing...



Source: U.S. Bureau of Labor Statistics

American workers exercised their bargaining power, resulting in higher nominal wages throughout 2021 and 2022. While all available real-time measures of wage growth have blind spots and flaws, they collectively signaled a momentary spike in upside wage pressures over this period, as employers were tempted to offer aggressive raises. (See the appendix for more about the methodological issues related to prices and wages.)

Since that time, job-switching rates have returned to their pre-pandemic peak. Wage growth has slowed, though it remains elevated relative to pre-pandemic growth rates.

Despite elevated nominal wage growth, the rise in prices substantially eroded real wages in 2021 and 2022. The American worker does not typically receive a contractual inflation adjustment as part of their compensation. In a period of price volatility tied to unique supply shocks and rapid growth in employment and household demand, changes in the cost of living tend to overwhelm gains in wages.

Upside energy and food price volatility tied to geopolitical conflict helped swamp the nominal wage gains. Strong consumer demand during the reopening of the economy, alongside long-duration supply chain bottlenecks, further stoked additional price volatility across a range of commodities, finished goods, and ultimately, services. In a period of volatile, inflationary shocks, the American worker tends to see declining real wages, and 2021 and 2022 was no exception in this regard.

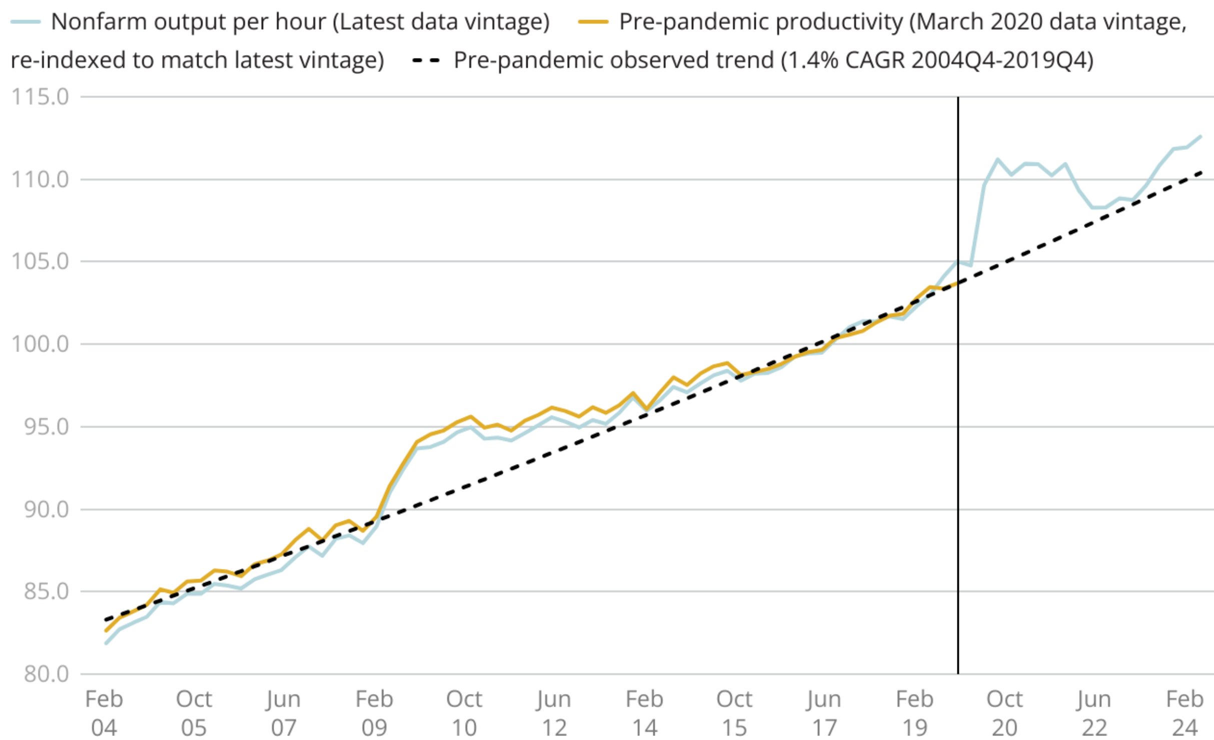
But inflation has sharply slowed since the summer of 2022, while nominal wage gains have continued because of the persistently tight labor market—leading to real wages growing across virtually all measures. In fact, the recent recovery in real wages looks more similar to what we saw in the final years of the 2010s before the pandemic, when recovering employment and job-switching rates coincided with an uptick in nominal wage growth without stoking proportional cost of living increases.

A promising and productive future

Should the strong labor market continue as cost of living increases abate, we can expect a bright future for the American worker. It will take time to fully digest some of the inflation shocks, and some good fortune to avoid future shocks. But we are already seeing that it is possible for tight labor markets to be sustained alongside real wage gains.

The American worker is benefitting from faster real wage gains at a time when labor productivity is also showing renewed acceleration. Productivity is typically distorted by recessions, spiking as a result of employment temporarily falling faster than output before ultimately reverting as employment recovers. After a downdraft in 2022 tied to supply shocks, the rebound of the past four to six quarters now places productivity above its pre-pandemic trend.

Figure 3: Productivity has now accelerated above the pre-pandemic trend



Source: Federal Reserve Bank of St. Louis

A rapid employment recovery and more employer-side competition have likely enhanced the productivity of the American worker in recent quarters. As the US economy also experienced in the latter half of the 1990s, employment rates approaching a more complete recovery can cause job growth to endogenously slow even as output and productivity accelerate.

A faster recovery has accelerated the timeline by which the American worker can accumulate experience and human capital, and translate it into productive output. To the extent this experience is also forming within superior matches between workers and employers, the productivity gains could potentially prove larger and more sustained.

Despite some manageable risks, a promising foundation is in place. While a future recession or new inflationary impulses may still prove fatal for this labor market, re-establishing a high level of employment has created a unique platform for the American worker to continue making progress.

Appendix: A note about prices and wages

Imperfect concepts and measurements make it difficult to determine if and how much the American worker is coming out ahead on their real wage. Each American, furthermore, has a unique consumption basket and wage. Some American workers could be coming out substantially ahead, while others remain behind. The measures of prices and wages used for calculating real wages can easily be cherry picked.

Pessimists might choose to focus on the upwardly biased Consumer Price Index, which grew at roughly a 4.6 percent annualized rate in the four years following the onset of the pandemic, in contrast to a 1.7 percent growth rate in the latter half of the 2010s.

Optimists can use the more downwardly biased Personal Consumption Expenditures deflator, which has grown by an annualized 3.9 percent post-pandemic, which is still substantially higher than its 1.4 percent annualized rate in the late 2010s.

There are good arguments for both measures, which reflect different but equally important concepts for measuring American workers' inflation-adjusted compensation.

	Annualized growth rates			Accelerative relative to pre-pandemic trends	
Wage measures	**Since the pandemic (2020-24)**	**Latter 2010s (2015-19)**	**Earlier 2010s (2010-14)**	**Post-pandemic vs. latter 2010s**	**Post-pandemic vs. earlier 2010s**
CES - average hourly earnings (all employees)	4.90%	2.80%	2.00%	2.10%	2.90%
CES - average hourly earnings (rank-and-file)	5.50%	2.80%	2.00%	2.60%	3.50%
CPS (median)	5.10%	3.30%	2.20%	1.80%	2.90%
CPS (lowest quartile)	5.70%	4.10%	1.70%	1.70%	4.00%
ECI (wages & salaries)	4.20%	2.60%	1.80%	1.60%	2.40%
Price measures	**Since the pandemic (2020-24)**	**Latter 2010s (2015-19)**	**Earlier 2010s (2010-14)**	**Post-pandemic vs. latter 2010s**	**Post-pandemic vs. earlier 2010s**
CPI	4.60%	1.70%	1.80%	2.90%	2.80%
PCE deflator	3.90%	1.40%	1.60%	2.60%	2.30%
Core CPI (less food & energy)	4.20%	2.10%	1.60%	2.10%	2.50%
Core PCE (less food & energy)	3.70%	1.60%	1.50%	2.10%	2.10%

Note: Blend of 1-, 3-, 12-month moving averages where available.

If the goal is to carefully track the evolution of labor cost inflation tied to a specific occupation, the Employment Cost Index (ECI) is the best available wage measure. But it misses the benefit that American workers derive from switching into typically better-paying jobs—and such job-switching has likely played a critical role in allowing the American worker to get ahead during the recent period of high inflation.

ECI grew at a relatively weak 4.2 percent annualized rate in the four years following the pandemic. In the latter half of the 2010s, ECI grew at a 2.6 percent annualized rate, and in the earlier half of the decade it grew at a paltry 1.8 percent pace. If deflated using CPI, real ECI estimates would actually show declining real wages over the past 4 years.

Alternative wage measures better capture the value of workers being able to switch into higher paying jobs. These measures have their own set of biases and blind spots, but those issues largely stabilize over longer time horizons.

Average hourly earnings estimates from the Current Employment Statistics survey, for example, grew at a 4.9 percent annualized pace for all employees since the start of the pandemic. For rank-and-file employees, this measure grew at a 5.5 percent pace since the pandemic's onset, compared to 2.8 percent in the latter 2010s, and a mere 2.0 percent in the early 2010s.

Measures of wage growth from the Current Population Survey grew 5.1 percent annualized since the pandemic, in comparison to 3.3 percent in the latter 2010s and 2.2 percent in the early 2010s.

No matter the chosen price deflator, these wage measures show meaningful inflation-adjusted gains. The pace of real wage gains are generally slower than the latter 2010s but still markedly faster than what transpired through the earlier half of the 2010s.

	Annualized growth rates			Accelerative relative to pre-pandemic trends	
Real wage measures	**Since the pandemic (2020-24)**	**Latter 2010s (2015-19)**	**Earlier 2010s (2010-14)**	**Post-pandemic vs. latter 2010s**	**Post-pandemic vs. earlier 2010s**
CES - average hourly earnings (all employees)	+0.3% to +1.2%	+0.7% to +1.4%	+0.2% to +0.4%	-0.8% to 0.0%	0.1% to 0.8%
CES - average hourly earnings (rank-and-file)	+0.9% to +1.8%	+0.7% to +1.5%	+0.2% to +0.4%	-0.3% to 0.6%	0.7% to 1.3%
CPS (median)	+0.5% to +1.4%	+1.2% to +2.0%	+0.4% to +0.7%	-1.1% to -0.3%	0.1% to 0.7%
CPS (lowest quartile)	+1.2% to +2.1%	+2.0% to +2.8%	-0.3% to +0.1%	-1.3% to -0.3%	1.5% to 2.0%
ECI (wages & salaries)	-0.3% to +0.6%	+0.6% to +1.3%	-0.1% to +0.3%	-1.3% to -0.5%	-0.3% to 0.3%

Note: Ranges derived using headline and core CPI & PCE from table above.

Real wage growth looks better further down the wage distribution. As noted earlier, average hourly earnings for rank-and-file employees, who typically earn lower wages on average, grew an annualized 0.6 percentage point faster than across all employees over the past 4 years.

The Current Population Survey reveals a similar scale of wage outperformance for those in the lowest wage quartile relative to those at the median of the wage distribution. Comprehensive and cross-sectional analyses from David Autor, Arin Dube, and Annie McGrew suggest that this compression extends to real wage outcomes as well. Real wages grew most rapidly for those at the lower end of the wage distribution, consistent with pre-pandemic trends.

Anxieties and disappointment about the level of real compensation undoubtedly remain. Although real wages are higher for most American workers than before the pandemic, there is likely some disappointment relative to growth rates achieved before the pandemic, when labor markets were similarly tight but there was far less volatility. Even if American workers are seeing real wage gains consistent with past trends, price volatility for salient items remains an understandable source of uncertainty for the American worker.

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

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[1] The unemployment rate tends to miss the dynamic components of labor force participation, which wax and wane with the business cycle and can understate the scale of recessionary damage. It is easier for surveys to identify correctly whether or not an American is employed than whether a non-employed American counts as a labor force participant.

The problem becomes notably clear when cyclical moves in labor force participation are taken into account. Following the previous two recessions, for example, the prime-age employment-to-population ratio fell more substantially than the unemployment rate alone implied. Much of the decline in the unemployment rate in the early 2010s was catalyzed by declining prime-age labor force participation. Only in the latter few years of the 2010s did we see a reversal of this dynamic, with low levels of unemployment also coinciding with rises in labor force participation and healthier levels of prime-age employment.

And despite claims of a shallow recession in 2001, the unemployment rate would have exceeded 7.5 percent—instead of its actual 6.3 percent peak—if not for simultaneous declines in participation. Today's outcomes have avoided the scars associated with previous recessions, even reaching new heights in the process.