FRBSF Economic Letter

2021-26 | October 4, 2021 | Research from the Federal Reserve Bank of San Francisco

From Gaps to Growth: Equity as a Path to Prosperity

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The pandemic has shined a vivid light on the deep roots of economic inequity, showing that the rules are not the same for everyone. Persistent, unfair gaps in opportunity and well-being across different groups in our society limit people's potential. Eliminating these inequities could substantially boost GDP and increase the economy's long-run rate of growth, leading to greater prosperity for all. The following is adapted from remarks by the president of the Federal Reserve Bank of San Francisco to the UCLA Anderson Forecast Webinar on September 29.

As Americans, one of our most deeply held beliefs is that anyone, no matter where they come from or who they are, can make it. They just have to work hard and play by the rules. This assumption permeates our political system, our institutions, and our economy.

But crises can be illuminating. The pandemic has shined a vivid light on the deep roots of economic inequity, forcing us to recognize that the rules aren't the same for everyone. COVID has taken the most from the people and communities that are least able to bear it. And long-standing gaps in economic opportunity and well-being have grown deeper and wider.

As humans, we are adaptive. We get used to things. We live a certain way for long enough, and we begin to believe that's the way it's supposed to be. We forget that the gaps we see every day reflect accumulated inequities—the long tail of policy, luck or inattention that has made it easier for some and harder for others to reach their potential. And then, an economy that leaves large numbers of people behind starts to seem normal.

I'm going to talk about why this way of looking at the world limits our potential, and how we can use the lessons of the pandemic to forge a more equitable society—one with fewer gaps and greater prosperity for all.

The bridle of our assumptions

Now, before we imagine a more equitable world, it's important to take stock of the one we have. Economists and many others generally assume that resources are allocated according to their most productive uses and that all available resources are fully deployed. Unless there is blatant market failure—collusion, discrimination, or other obvious barriers to entry—we believe that any differences in initial conditions will smooth out over time. In other words, no matter where you are born or how you start out, the marketplace will ensure that you land where you're supposed to be.

And there are many examples of this being true. Amazing stories of people starting with little and doing a lot—confirming our belief that markets work efficiently and human capital is put to its best uses with few mistakes.

But this can be misleading. It can make us think that the world we have is all it could ever be. And this bridles our economy's potential. It leaves countless people contributing less than their talents and interests would allow, sometimes sidelining them completely.

Gaps

To get a sense of what we stand to gain from building a world with few gaps, it's useful to review what some of the disparities look like. Many groups fare less well than the averages we hear about each day. But disparities for Black Americans, many of whom bear the costs of both historical and current discrimination, are especially sizeable. So, their experiences are an important starting point.

The differences start at a young age. The average Black child in the United States is about three times more likely than the average white child to live in a poor household—one with resources below the official poverty line (U.S. Census Bureau 2021). Black children are relatively less likely to graduate from high school and even less likely to go onto college. For example, in 2019 the high school graduation rate for Black students was 80%, compared to 89% for white students (National Center for Education Statistics 2021). In 2019, the college enrollment rate for recent Black high school graduates was a little over 50%, compared to roughly 67% for whites (Bureau of Labor Statistics 2020).

Black students who do go to college don't always finish. In fact, a recent cohort study found that at the six-year mark 45% had not graduated and were no longer enrolled. By comparison, only 27% of white students had left without graduating (Shapiro et al. 2017). These differences in completion rates trace back to a variety of factors including finances, academic preparation and support, and representation (National Center for Education Statistics 2019 and Espinosa, Turk, Taylor, and Chessman 2019).

But the gaps don't end with education. They continue on into the labor market and beyond. Black college graduates are less likely to be employed than white college graduates and, when they do find jobs, are more likely to be in occupations that do not utilize, or even require, their skills (Williams and Wilson 2019, Abel and Deitz 2019, Daly, Hobijn, and Pedtke 2020, and Buckman, Choi, Daly, and Seitelman 2021). All of this translates into lower average earnings for Black Americans even when they have college degrees.

Perhaps most troubling, college-educated Black workers lose ground over their careers. Indeed, in work that my colleagues and I have done, we found that the earnings gap between Black and white college-educated men doubles over the first 15 years of their professional life (Daly, Hobijn, and Pedtke 2020).

In the end, this means that fewer Black men and women are contributing their full potential to the economy. But it doesn't stop there. Hispanic Americans, women, indigenous Americans, people living in rural areas, and many other groups persistently fall behind, with lower rates of education, employment and earnings than we might expect if opportunities were equitably available (Buckman, Choi, Daly, and Seitelman 2021, Shrider, Kollar, Chen, and Semega 2021, Bureau of Labor Statistics 2019, Blau and Kahn

2017, Marré 2017, Glaeser 2011, Akee 2021, and Bengali, Daly, Lofton, and Valletta 2021). Some of the groups deviate from the general patterns described. For example, Hispanic American men have higher employment rates than men from other racial and ethnic groups, and women are more likely to hold college degrees than men.

Leaving these gaps unaddressed is clearly unfair. But it's also unproductive. It keeps millions of people on the sidelines or underutilized and sells the economy short. No entrepreneur would ever stand for it. The question is, why do we?

From gaps to growth

One reason is that we don't fully understand what we're missing. We don't regularly calculate the losses from exclusion or the potential gains from being more inclusive—at least, not on an aggregate, economy-wide level. My colleagues and I recently did just that.

We asked a simple question: What would the economic output of the nation be if gaps in outcomes by race and ethnicity were erased (Buckman, Choi, Daly, and Seitelman 2021)? For each year from 1990 to 2019, we eliminated gaps in employment, hours, education, and educational utilization. And we gave racial and ethnic minorities the values of their white counterparts. We then recomputed the potential output for each year. What we found was significant.

When gaps are closed, the gains from equity are nearly $23 trillion over a 30-year period—a large piece of the economic pie unrealized or simply left on the table by tolerating the gaps that we see.

Other studies have found similar potential gains. For example, a 2014 study found that closing racial gaps in income in 2012 would have increased GDP by $2.1 trillion that year (Truehaft, Scoggins, and Tran 2014). More recently, a study conducted by leading researchers in the private banking sector found that closing gaps between Black and white adults in wages, higher education, home ownership, and entrepreneurship would have led to a GDP boost of $16 trillion over the past 20 years, and a projected $5 trillion gain over the next five years (Peterson and Mann 2020). In other words, a range of studies, using different methods and closing different gaps, all point to the same thing: substantial gains from a more inclusive economy.

But how will we get there? A recent study done by scholars at Stanford University and the University of Chicago provides some clues. They look back in time and examine the economic impact of taking down barriers to entry for women and Black workers in the fifty years spanning 1960 to 2010 (Hsieh, Hurst, Jones, and Klenow 2019). They find that better allocation of these workers throughout the economy—putting talent where it was needed—accounted for between 20 and 40% of the total growth in U.S. output over the period. Moreover, they showed that most of this improvement came from reducing human capital barriers and labor market discrimination. Simply put, removing barriers for some improved output for all.

These and other studies make it clear that using all of our resources more fully improves aggregate prosperity. But the gains are likely to go beyond a boost in the level of GDP. Reducing disparities could also increase the economy's long-run rate of growth.

To understand why, we need to go back to the 1980s, when future Nobel laureate Paul Romer had an idea. He hypothesized that the driver of economic growth is really ideas—innovations in thinking that lead to the development of new technologies, higher productivity, and more and faster growth over the long run (Romer 1990, 1994). In other words, ideas determine how quickly the economic pie grows. See Jones (2019) for an overview of the original work and subsequent literature.

His theory tells us that we can boost GDP growth by investing in strategies that foster the development and implementation of ideas. And not just of a few, but of everyone.

The first and most obvious strategy to boost the generation of ideas is to increase access to high-quality education and the academic supports needed to help students stay on course. Education equips people with the knowledge and the skills they need to innovate. And it doesn't always take a four-year degree. Think of all the computer programmers out there who started coding as kids. Investing in students at an early age and offering them a pathway to learn is equally important (García, Heckman, Leaf, and Prados 2020 and Rolnick and Grunewald (2003).

Another way to encourage idea generation is to create more equitable ways to fund them. Wealth enables people to implement their ideas. But wealth gaps are large in our country, and racial and ethnic minorities are especially far behind (Bhutta et al. 2020). Gaps in financing or borrowing to fund ideas are also large (see Federal Reserve Banks 2021 and Apgar and Calder 2005). This means that whole communities of people have less financial support for putting their innovations into practice.

Finally, we need to increase diversity and inclusion in businesses and government. A large and growing body of research shows that diverse teams enhance performance. Less diverse teams eat into profitability (see, for example, Kline, Rose, and Walters 2021 and Herring 2009). I see this in my own organization every day. The best teams are the most diverse teams—ones that include a range of views, backgrounds, and experiences.

The bottom line is this: making sure everyone has a chance to generate and nurture their ideas is good for growth, and ultimately delivers greater prosperity to us all.

Switching our lens

Now, I want to leave you with a story. A girl from a lower income family does well in school, reads a lot, likes to learn. But the family finances, and the family itself, fall on hard times. And the young girl, needing to assist, drops out of school. When she tells her teacher she is leaving, he doesn't blink. He says he always knew that she wouldn't amount to anything, and that her decision has just confirmed it.

Fast forward a few years, and the girl meets a woman named Betsy. And Betsy tells her that the job she wants, to drive a bus, requires a GED, and so do many others. So, the girl gets one. Then, Betsy tells her that many more jobs require college and that she should go. And on it goes, until one day the girl—now a woman—earns a Ph.D. and heads off into the world to try and make a difference.

That girl, as you might have guessed, was me. And I tell you that story to show one thing: the lens we use determines what we do. My teacher and Betsy saw me differently. And because they saw me differently, they acted differently towards me. Betsy paid for my first semester of college. My teacher simply erased me.

We can take for granted that the outcomes we see today are inevitable and watch as the pandemic makes existing gaps deeper and our prospects for future growth even slower. Or we can see them as a sign that resources aren't being used to their fullest, and that people with great potential are being kept each day from realizing it.

The choice is clear. The will is ours.

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