Prepared Testimony on "Economic Disparities and the Economic Challenges Facing American Families"

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Thank you for the opportunity to testify on the important topic of economic disparities. I am the Aetna Professor of the Practice of Economic Policy at the Harvard Kennedy School and also in the Economics Department at Harvard University. I am also a Non-resident Senior Fellow at the Peterson Institute for International Economics. I do research and teaching on a wide range of economic policy issues.

The American economy had pervasive disparities before the pandemic. The pandemic exacerbated many of those disparities in market outcomes but the policy response, in many ways, was successful in combatting some of the widening disparities. The policy response, however, was temporary and the pre-existing structural problems in the U.S. economy will remain. That is why I am so pleased that this Select Committee is tackling what I view as the fundamental challenge our economy, and perhaps our society more broadly, faces.

My testimony makes six points:

1. American families are making much slower economic progress than they have in the past.

2. The source of this slower progress is a combination of slower productivity growth, higher inequality, and a reduction in work.

3. Disparities are pervasive by income, education, race, ethnicity, gender and many other dimensions. They express themselves in almost every area including the economy, education, environment, health, housing, clean water, crime, and more.

4. Inequality has many causes and it also has commensurately many solutions—there is no single magic bullet.

5. There are many opportunities to reduce disparities while boosting overall growth and policymakers should pursue all of them.

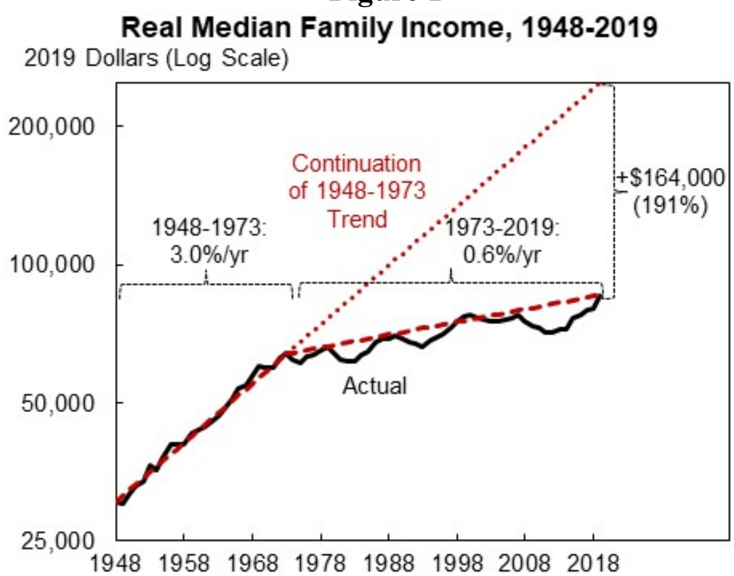
6. Finally, there are additional ways policymakers could reduce disparities in order to help American families with relatively little impact on growth and policymakers should purse those as well.

The remainder of my written testimony expands on these six points.

1. American families are making much slower economic progress than they have in the past.

From 1948 to 1973 the typical American family saw their income increase 3 percent annually. At that rate incomes doubled every 23 years, or once a generation as show in Figure 1. Since 1973 median family income has risen 0.6 percent annually, a pace that means it would take over one hundred years for incomes to double. The median family is still making progress but at a much slower rate than they were before and also at a much slower rate than should be possible given that the overall economy has been growing at a 1.7 percent annual rate per family—instead, the bulk of these aggregate gains have been going to households at the top of the income distribution. Overall, if family incomes had continued growing at their 1948-73 pace in the years since then they would be $164,000 higher today.

Figure 1



Source: U.S. Census Bureau; Macrobond; author's calculations.

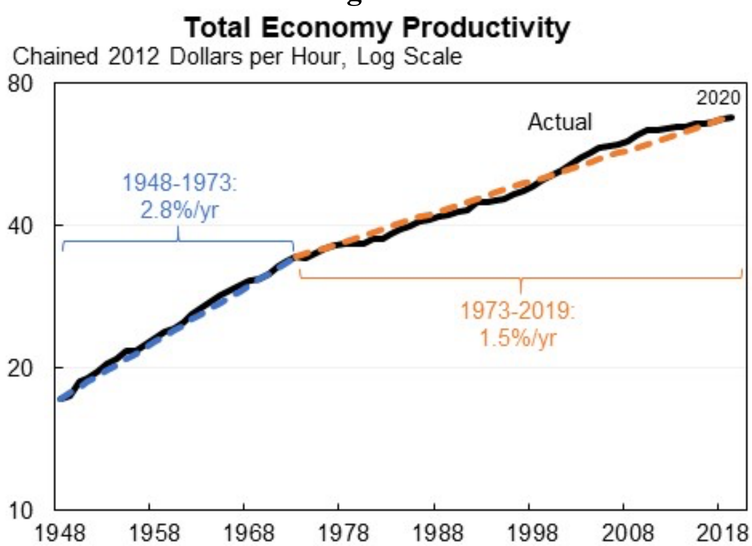
My colleagues Raj Chetty, Nathaniel Hendren and co-authors (2017) have documented a similar trend in the well-being of children compared to their parents. A son born in 1940 was almost certain to be better off than his father while it was far from a certain bet for a son born in 1984.

2. The source of this slower progress is a combination of slower productivity growth, higher inequality, and a reduction in work.

Three unfavorable developments have combined to result in the slowdown in the typical household's income:

- Productivity growth has slowed. A popular perception is that businesses are getting more and more innovative and efficient. This popular perception is not borne out by the economic data. From 1948 to 1973 productivity grew at a 2.8 percent annual rate but it has slowed to an 1.5 percent annual rate in the nearly half century since then, as shown in Figure 2. A number of hypotheses have been advanced for this slowdown including the unusually high productivity growth in the post-war years driven by World War II innovations (Gordon 2017), the claim that good ideas are getting harder to find (Bloom et al., 2020), and the speculation that productivity growth will pick-up with a lag when we figure out how to deploy innovations in areas like artificial intelligence, advanced materials, and personalized medicine (Brynjolfsson, Rock, and Syverson 2018).[1]

Figure 2

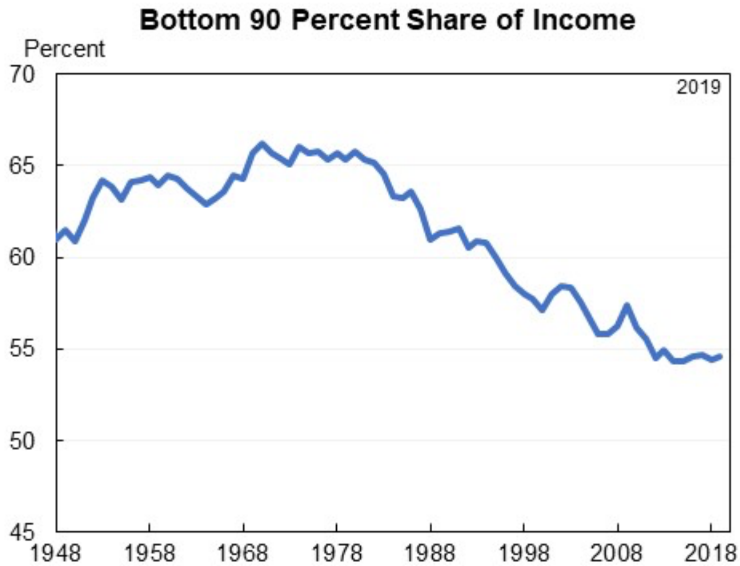


Source: Bureau of Economic Analysis; Bureau of Labor Statistics; Macrobond; author's calculations.

- Inequality has increased. Income inequality was roughly stable in the decades after World War II as the share of income going to the bottom 90 percent of Americans rose slightly from 61 percent in 1948 to 65 percent in 1973 as shown in Figure 3. Over the following decades income inequality increased dramatically and the share of income going to the bottom 90 percent fell to 55 percent by 2019. Many other disparities and their causes are discussed in greater detail in the next points in my testimony.

[1] Some have argued that productivity growth is higher than the official statistics say (e.g., Feldstein 2017). This is likely true but was also likely true in the post-war period so would probably not change the magnitude of the productivity slowdown very much, if at all (Byrne, Fernald, and Reinsdorf 2016).

Figure 3



Source: World Inequality Database; author's calculations.

- Labor force participation has fallen. In the second half of the twentieth century one of the large forces fueling American economic growth was the entry of women into the labor force as discrimination was reduced (but not eliminated), cultural norms changed, and institutions became more accommodating (Goldin 2021). For a while, the increasing prevalence of two-earner households helped make up for some of the challenges to incomes associated with slowing productivity growth and rising inequality. Since 2000, however, labor force participation for women aged 25-54 (what economists term "prime age") has flat lined as shown in Figure 4a. At the same time, men have increasingly withdrawn from the labor force over the last seventy years, further compounding the problem, as shown in Figure 4b.

Figure 4a

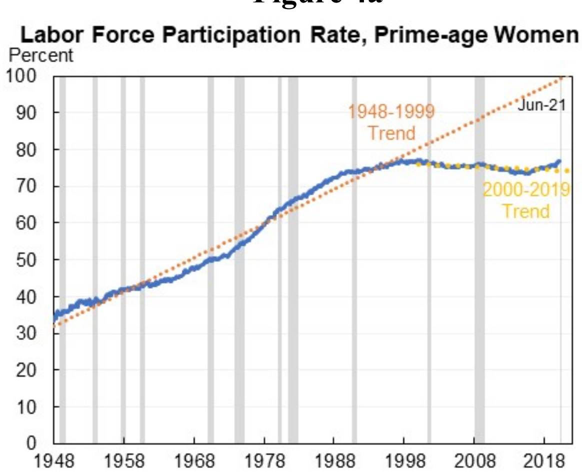
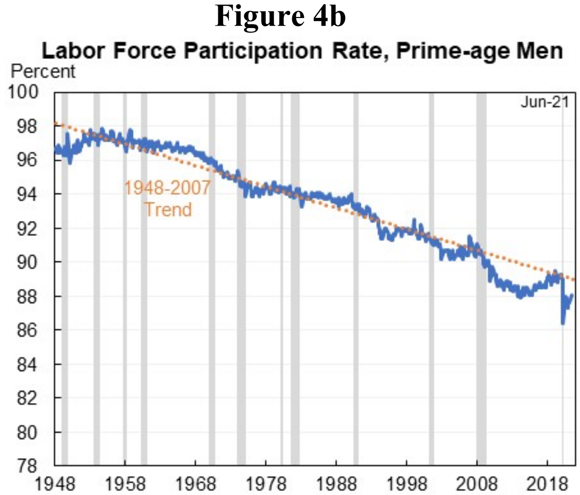


Figure 4b



Note: Shading denotes recession.
Source: Bureau of Labor Statistics; author's calculations.

These unfavorable developments have combined to result in the dramatic slowdown in income growth. The pie has grown more slowly since 1973 and increasingly less of the pie is going to households with incomes in the bottom 90 percent. At the same time, fewer men are working without an offsetting increase in work among women. In the remainder of my testimony I will focus on disparities but would note that policies that increase economic growth are also a very important and powerful way to raise incomes and remedy some of the problems associated with the disparities I will be discussing.

3. Disparities are pervasive by income, education, race, ethnicity, gender and many other dimensions. They express themselves in almost every area including the economy, education, environment, health, housing, clean water, crime and more.

My testimony today goes most deeply into economic disparities because, in many ways, they are among the profound and important disparity and also because that is my greatest area of expertise. It is critical, however, to understand that this is just one of an interrelated set of disparities in two senses. First, disparities are not just experienced across different economic groups but also are experienced based on education, race, ethnicity, gender, and many other dimensions including geography. Second, disparities are very stark in terms of other outcomes including a wide range of economic outcomes, education, the environment, health, housing, clean water and more. A long book could be written documenting all of these interrelated dimensions of disparities so I will confine myself here to a few brief but striking aspects of them.

Disparities among different groups

- Income. The top 1 percent of households got 18 percent of the income in 2017 while the bottom 20 percent of households only got 2 percent of the income. These disparities are substantially larger than they were in 1979 when the top 1 percent of households got 10 percent of income and the bottom 20 percent of households got 3 percent of income.

- Education. The unemployment rate for people with a high school degree or less was 4.0 percent in 2019 as compared to 2.2 percent for people with a college degree. Moreover, the unemployment rate for people with a high school degree or less increased much more in the pandemic, with the unemployment rate of people with a high school degree or less rising by 13.1 percentage points at its peak while the unemployment rate of people with a college degree or more rose by 7.2 percentage points.

- Race and ethnicity. Table 1 shows a variety of statistics by race and ethnicity, showing that income, wealth, employment, poverty, and other economic outcomes are systematically much worse for Black and Hispanic or Latino people and households. Note that some of these disparities have not changed for decades: the Black-white male earnings gap is about as large as it was in 1950 (Bayer and Charles 2018).

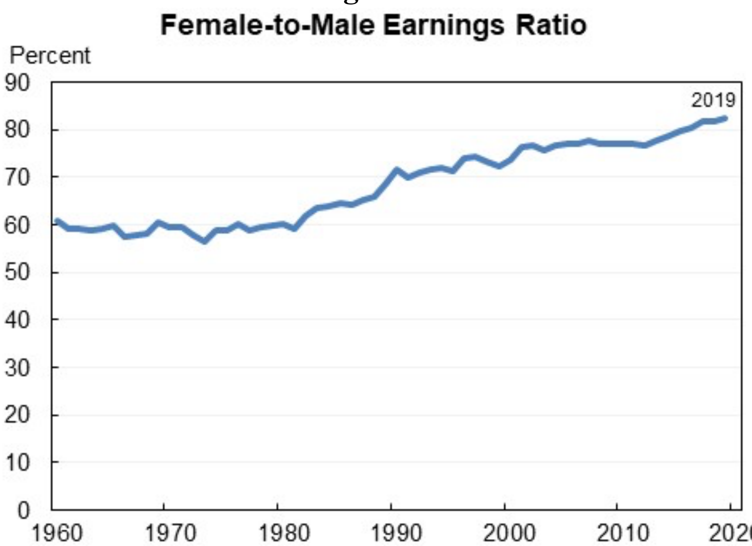
Table 1

	Total	Asian	Black	Hispanic or Latino	White
Unemployment Rate (2020)	8.1	8.7	11.4	10.4	7.3
Median Household Income (2019)	$68,703	$98,174	$45,438	$56,113	$72,204
Poverty Rate (2019)	10.5	7.3	18.8	15.7	9.1
Median Family Net Worth (2019)	$121,700	N/A	$24,100	$36,200	$188,200
Percent Uninsured (2019)	8.0	6.2	9.6	16.7	7.8

Source: U.S. Census Bureau; Bureau of Labor Statistics; Board of Governors of the Federal Reserve System.

- Gender. A woman working full-time earns 82 percent of what a man earns, a disparity that is smaller than it was sixty years ago but progress has been uneven, as shown in Figure 5.

Figure 5



Source: U.S. Census Bureau.

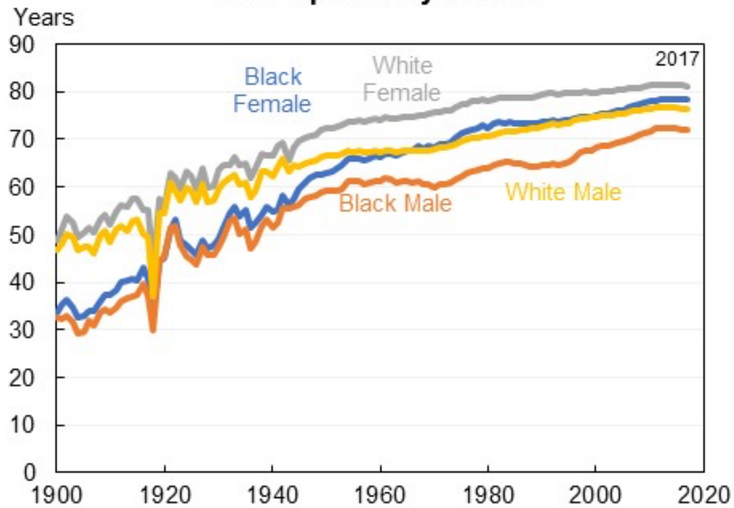
Note that these disparities have many sources. For example, much of the difference between the earnings of men and women is accounted for by different occupational choices and career paths—and not by differences in pay for identical jobs for people with identical work and educational experience. This means that to understand this disparity we need to understand the sources of these different occupational and career paths, including the role played by the educational system, the availability of childcare and flexible work, the dynamics within families regarding childcare, and the institutional setup of jobs. Many of these disparities are not simple stories of "discrimination" based on animus grounded in race or gender but are the result of broader systems with deep historical roots.

Disparities along different dimensions

- Health. While the Black-white life expectancy gap has narrowed since 1900, life expectancy continues to be 2.7 years lower for Black women relative to white women and 4.5 years lower for Black men relative to white men as shown in Figure 6. Since at least 1990, the gap in life expectancy in adulthood between those with and without a bachelor's degree has been growing, with life expectancy for those without a bachelor's degree falling since 2010 (Case and Deaton 2021).

Figure 6

Life Expectancy at Birth



Source: Centers for Disease Control and Prevention.

- Education. Large performance gaps have persisted between children and the lowest and highest socioeconomic-status quintiles (García and Weiss 2017). There also remain large gaps in educational attainment with bachelor's or higher completion rates 14 percentage points lower for Blacks and 19 percentage points lower for Hispanics relative to whites (United States Department of Education, National Center for Education Statistics 2020).

- Housing. Income and wealth differences, along with institutional racism have contributed to substantially lower rates of homeownership among Black and Hispanic households (Haughwout et al., 2020). Most low-income families, including those receiving Housing Choice Vouchers live in high-poverty, low-opportunity neighborhoods (Mazzara and Knudsen 2019)

- Environment. Exposure to air pollution, which has been linked to numerous adverse health outcomes, tends to be greater for Black, Hispanic, less educated, and poorer populations (Bravo et al, 2016).

- Clean Water. Lead pipes, which are more common in older houses and lower-income areas, can increase risk of lead exposure which is associated with serious health, developmental, and long-term harms (Centers for Disease Control and Prevention 2021).

- Crime. Those with household income less than $15,000 are victims of violent crime at a rate that is 3 times as high as for those with household income of at least $75,000 (Bureau of Justice Statistics n.d.). Black people are disproportionately victims of homicide, representing more than 50 percent of all murder victims in 2019 (United States Department of Justice, Federal Bureau of Investigation 2020).

Note that these disparities are all interrelated. For example, different economic situations contribute to different access to quality education and different access to quality education leads to different economic outcomes. Access to a clean, safe home environment with water that is not poisoned with lead is important to outcomes for children as they grow up and similarly their economic outcomes shape their access to a clean, safe home environment.

Finally, some of these disparities have narrowed over time but many others have widened—as discussed in detail in the case of income inequality in my next point. Moreover, all of them are related to the overall macroeconomic situation and so when the economy booms many of these disparities are reduced while recessions and periods that fall short of full employment can exacerbate these disparities.

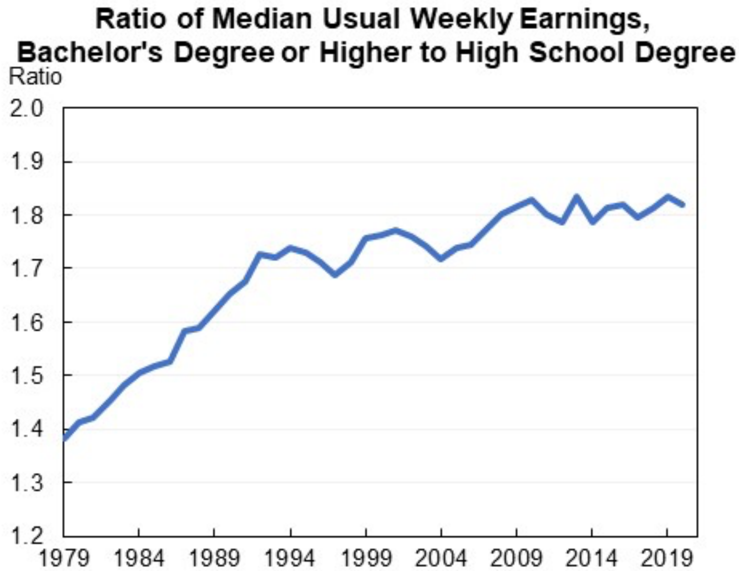
4. Inequality has many causes and it also has commensurately many solutions—there is no single magic bullet.

Economists can get in heated debates over *the* cause or *the primary* cause of higher inequality. I personally am much less excited about these debates because the rise in inequality has been so large that it leaves room for many possible causes. Moreover, the causes will vary depending on the facet of inequality, whether it is earnings or capital income, the very top or the middle or the bottom, the decades that are considered and more. There is no one type of inequality and each type of inequality does not have just a single cause. Instead, I find it more fruitful to inform public policy choices by understanding that many causes of inequality, which will motivate the need for many solutions—instead of a fruitless pursuit of a single magic bullet.

I classify the explanations for higher inequality into two broad categories: *competitive explanations* and *institutional explanations*.

Competitive explanations are grounded in understanding wages for different educational or skill groups as determined by the level that is needed to equilibrate the demand and supply of labor for those groups. The race between education and technology emphasizes that wages for college graduates have risen relative to non-college graduates because technological changes led companies to increase their demands for workers with college degrees at the same time that there was a slowdown in the number of workers with such degrees as shown in Figure 7 (Goldin and Katz 2008). A richer modelling of different types of occupations and the skills needed for them can help explain more nuanced changes in earnings of low-, middle- and high-wage workers through a model of "polarization" whereby technology replaces low-wage jobs, is neutral for middle-wage jobs and complements high-wage jobs (Autor, Levy and Murnane 2003 and Autor and Dorn 2013).

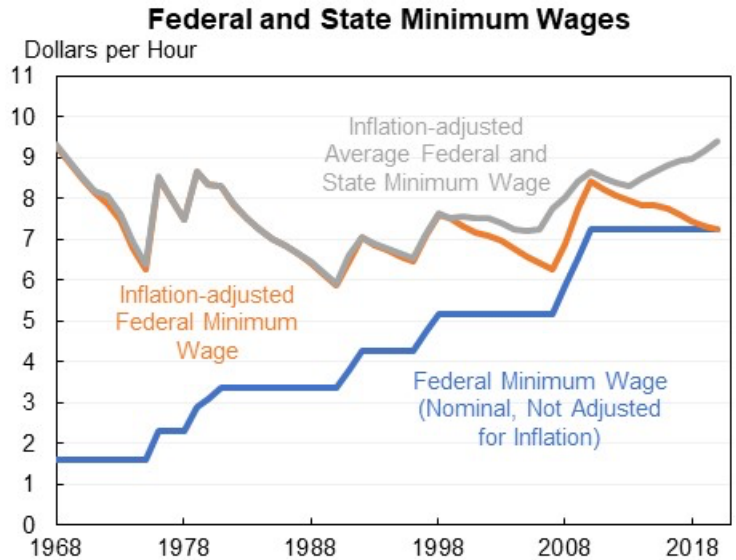
Figure 7



Source: Bureau of Labor Statistics; author's calculations.

These explanations have a reasonable amount of explanatory power for earnings (as opposed to capital income), especially for bottom 95 percent of workers, and especially differences by education. There is much, however, that the competitive model does not explain and moreover it is not a fully realistic model of labor markets in which it takes time for workers to find jobs and workers are not like replaceable cogs in the machines. Employers have some power to set wages and even if they lower wages below the "market wage" they still will be able to get workers. These observations have given rise to *institutional models* which seek to understand the ways in which rules and institutions shape the relative power of employers and workers in their bargaining over wages (see Council of Economic Advisers 2016 for a summary). One important institutional factor has been the decline in the real value of the federal minimum wage which reached a peak of 1968 and has fallen 22 percent in inflation-adjusted terms since then as shown in Figure 8. Another important institutional factor has been the decline in unionization which reached a peak of 34 percent of private sector workers in 1945 and has since fallen to 9 percent as shown in 2019 (Farber et al., 2021). In addition, other labor market rules and institutions can affect bargaining power and wages including occupational licensing rules, non-compete agreements, no-poaching agreements, illegal wage collusion and illegal wage theft.

Figure 8



Note: Inflation-adjusted using PCE price index.
Source: Bureau of Labor Statistics; Bureau of Economic Analysis; Flood et. al, 2020; U.S. Department of Labor; FRED; Macrobond; author's calculations.

Finally, in addition to these labor-market focused explanations the overall performance of the macroeconomy also plays a role in the level of employment, especially for the most vulnerable groups, and may also play a role in the growth of real wages, the trajectory of inequality, and in poverty. The economy appears to have operated below maximum employment for much of the last twenty years as evidenced by the fact that inflation has, on average, fallen short of the Federal Reserve's two percent goal and it was possible to lower unemployment and increase labor force participation without any appreciable increase in inflation. Higher levels of employment through a "high pressure economy" or "hot economy" are particularly important for disadvantaged workers, with the employment rates rising disproportionately more for workers who are Black, Hispanic or Latino, and those with lower degrees of educational attainment (Okun 1973 and Aaronson et al., 2019). In addition, a hot economy plays an important role in reducing poverty and may also reduce inequality and raise real wages (Katz and Krueger 1999 and Mishel and Bivens 2021, although see Nekarda and Ramey 2021 for a contrary perspective).

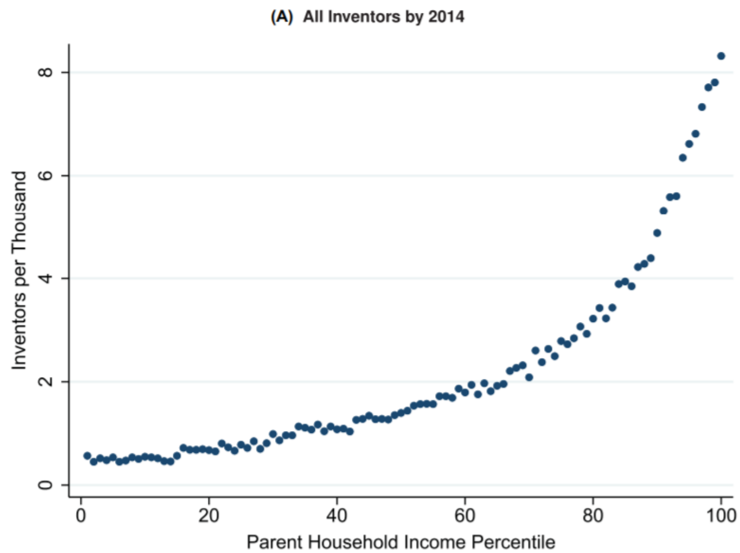
5. There are many opportunities to reduce disparities while boosting overall growth and policymakers should pursue all of them.

Many policies have the potential to simultaneously boost growth and employment while also reducing disparities. In fact, in many respects disparities themselves can serve as an obstacle to growth. A paper published in *Econometrica*, a top economics journal, by economists from the University of Chicago and Stanford University found that between one- and two-fifths of aggregate productivity growth between 1960 and 2010 could be explained by reduced discrimination that allowed a wider group of people to contribute to the economy (Hsieh et al 2019). Their paper proceeds from the (reasonable) assumption that talent is distributed equally but institutions, discrimination, racism, sexism and more keep it from being expressed equally.

Their starting example of this is the fact that "[i]n 1960, 94 percent of doctors and lawyers were white men. By 2010, the fraction was just 62 percent."—something that is evidence that all of these institutional barriers were reduced although not nearly eliminated over this period.

A complementary set of evidence comes from Bell et al. (2019) which finds that the rate of patenting is very closely related to family incomes as shown in Figure 9. If the ability to invent is not related to family incomes, then this is also evidence that we are missing out on what the authors call "lost Einsteins."

Figure 9
Patent Rates versus Parent Income



Source: Bell et al., 2019.

It is beyond the scope of this testimony to list all of the policies that have the potential to reduce disparities while boosting overall growth but I will list six areas—without claiming that this is a full list:

1. Education. Education increases human capital, a critical ingredient of economic growth. Education results in higher employment rates and higher wages. And the slowdown in educational attainment has played a role in the increase in inequality, as discussed under point 4. In particular, the United States could increase the quantity of education by making pre-K universal (as proposed in the American Families Plan) and expanding access to college, including through more extensive income-based repayment of loans.

2. Investments in children. A wide range of investments in children whether in the form of health, nutrition, cash, housing vouchers or education, have been shown to have long-term benefits for the children when they grow up in terms of higher employment rates, higher wages, lower mortality, and less likelihood of being in prison (Hendren and Sprung-Keyser 2020). Expanding investments along the lines of several of the proposals in the American Families Plan, including a child tax credit that is larger and fully available to lower-income households and expanded nutritional assistance.

3. Enabling work. The 70-year decline in prime-age men's work and the 20-year plateau in women's work is a cause for concern. Although policy should not be based on the premise that everyone should work, it should enable everyone to make that choice. Expanded pre-school and increased childcare support would enable more parents to make a choice about working. In addition, paid leave and more workplace flexibility could also help address some of the reasons that prime-age labor force participation is lower in the United States than in Europe (Blau and Kahn 2013).

4. Making the economy more competitive. Markets and competition are the most important source of economic growth. The increased concentration witnessed in many American industries has a variety of causes, some good (related to more innovative and competitive businesses) but many of them bad (related to more permissive anti-trust enforcement and increased regulatory barriers). Increased concentration can also reduce the bargaining power of workers, lowering wages and increasing disparities. A revitalized attempt to increase anti-trust enforcement, tighten competition rules and reduce regulatory barriers—along the lines of what motivated the bills recently reported out of the House Judiciary Committee and the President's Executive Order on competition—have the potential to strengthen growth while reducing disparities.

5. Increasing economic dynamism and fluidity. American workers are less likely to switch industries, occupations, jobs or move to new areas. Businesses have also become less likely to create and destroy jobs. Some of this reduction in dynamism and fluidity has been for good reasons, like better job matches, but much of it has not been. The result can be lower levels of employment, productivity growth and wages (Davis and Haltiwanger 2014). Steps to increase fluidity and dynamism include reducing occupational licensing and land use restrictions (Furman 2016).

6. Better macroeconomic policy. More expansionary monetary and fiscal policies can increase employment, employment disparities and potentially real wages. It is important that this not be overdone or done too quickly, I would dub my preferred approach "one log on the fire at a time" to continue to warm the economy—the recipe that was successful in the late 1990s and in the years prior to the pandemic. This means the Federal Reserve running more expansionary policy, including raising its inflation target, and also ensuring there is not premature and unnecessary fiscal consolidation.

6. Finally there are additional ways policymakers could reduce disparities in order to help American families with relatively little impact on growth and policymakers should pursue those as well.

Not all inequality is bad for economic growth and not all attempts to reduce inequality are good for growth. The fact that people can aspire to greater rewards through greater education, effort, or innovativeness is an important contributor to growth and the ability of the economy to generate jobs and incomes for a wide range of citizens. Moreover, while there are many win-win economic policies there are also many other policies that genuinely entail tradeoffs between different goals. If policymakers confined themselves only to win-win policies they would not do enough about disparities and leave millions of American families worse off. If you care enough about a goal you should want to pursue every single win-win policy you possibly can but also to pursue policies that advance your goal while entailing a comparatively smaller cost in other dimensions. If you care about something you should be willing to pay at least a small cost for it.

The way to balance the costs and benefits of policies that affect different parts of the income distribution differently depends on your values. From my perspective, for example, if a policy added $1,000 to the income of a billionaire while lowering the incomes of the middle class by $999 that might increase total GDP by $1 but that would make the country worse off. Conversely, even if a policy reduced GDP by reducing incomes for a billionaire by $1,000 in order to generate $999 for middle-class families, I would find that the country was better off—even if it did not show up in higher GDP. This argument is not motivated by any animus towards higher-income Americans—in many and perhaps even most cases, their incomes are a result of the large contributions they have made to the economy—it is just based on the observation that when you have a lot of money you are unlikely to miss some of it while if you have very little money then some additional could provide a large benefit.

Higher taxes on high-income households and corporations, by themselves, are unlikely to add anything to economic growth and a range of estimates suggests they may subtract a very small amount from economic growth, less than 0.1 percentage point per year, and an even smaller amount from general economic welfare. But I strongly support such tax increases, including almost all of the ones proposed by President Biden's American Jobs Plan and American Families Plan, because their very small costs are greatly outweighed by the benefits the resources they generate would create for economic growth and for lower- and middle-income families.

Raising the minimum wage is another policy that would help reduce disparities and increase incomes for many low-income Americans—a reason that is more than enough justification for it given the evidence that any associated employment losses are much smaller than the wage gains and possibly even non-existent (Cengiz et al., 2019 and Congressional Budget Office 2021).

In conclusion, the United States has large economic and social disparities. In many respects these disparities have hurt overall economic performance. There is no one solution to them but policymakers should do anything that can that both increases growth and reduces disparities—and then do a lot more to reduce disparities at an acceptable cost as well.

Thank you and I look forward to your questions.

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