Remarks by Secretary of the Treasury Janet L. Yellen at the 2022 'Virtual Davos Agenda' Hosted by the World Economic Forum

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My thanks to Klaus and to the World Economic Forum for hosting me.

At this time of year, government officials, business executives, and thought leaders normally huddle in a small town in Switzerland to share perspectives on how to address the world's biggest challenges. I hope to join you all in person in Davos in the coming years. In the meantime, the virtual nature of these meetings does not diminish the importance of the issues at hand.

We have all been living through the COVID-19 pandemic for roughly two years now. Policymakers, businesses large and small, and families alike have grappled with the uncertainty and unexpected twists of this ruthless pandemic and its associated economic disruption. At the same time, longstanding challenges persist, and some were exacerbated by a pandemic that disproportionately impacted low-wage workers and minorities. We still face growing divergence between rich and poor, within and between countries, along with the mounting risk of climate change. Our navigation of these health and economic challenges will be consequential: for ending the pandemic, for mitigating climate change, and for ensuring the stability and prosperity of our respective economies and the global economic system.

I will focus my remarks on the Biden Administration's strategy to sustain our economic recovery and to address longstanding structural issues relating to income inequality, racial disparities, and climate change.

Let me start with where I see the U.S. economy right now. By most traditional metrics, the pace of our current recovery has exceeded even the most optimistic expectations. That's due in large part to rapid vaccine deployment and the robust support to families, businesses, and state and local governments provided by the American Rescue Plan. This is the kind of recovery that President Biden set out to deliver when he took office last year.

Aggregate growth has been rapid and continued, with our real GDP expected to grow at 5.3 percent in 2021. The most recent Blue Chip forecast put 2022 growth at 3.3 percent, noting that "COVID and supply-chain disruptions to the economy are not really expected to disrupt economic growth," which in itself represents a stunning economic and policy achievement.

The U.S. labor market is exceptionally strong. Over 6 million jobs were added last year, and the unemployment rate is again below 4 percent. Other metrics, such as the fraction of workers who quit their jobs, suggest that the labor market is very tight. Historically, when quits have been high, workers have been moving to jobs they prefer: for higher wages and better working conditions. Indeed, we now see upgrading of job quality and increases in nominal wages, especially at the lower end of the spectrum.

Household and firm balance sheets are even healthier than before the pandemic. To date, we have not seen large or persistent increases in long-term unemployment, indebtedness, evictions, or bankruptcies. This contrasts with the aftermath of the Global Financial Crisis.

Of course, given the scale, novelty, and uncertain path of the pandemic, the recovery also comes with challenges. Labor supply has yet to recover to pre-pandemic levels, as health, childcare, and other related challenges remain. Inflation is a valid policy concern, and it has risen to levels not seen since the 1980s. It far exceeds any increase that would normally result from a labor market with 3.9 percent unemployment. I believe that the pronounced shift in spending away from services and toward goods contributed to outsized price increases. Additionally, the associated supply chain bottlenecks are boosting costs and holding back production of automobiles and other key products.

Despite these challenges, it's important to note that professional forecasters think that inflation will substantially abate next year. Part of this view is likely driven by the expectation that the Federal Reserve will continue to account for these pressures as it fulfills its dual mandate. And as the President has remarked many times, the Administration continues to tirelessly seek strategies to alleviate these pressures through actions such as easing congestion in our ports and expanding the labor supply. Yet, even as policymakers continue to address rising prices, our economic recovery will face significant risks until we have moved more decisively past the pandemic.

Now let me turn to economic policy. I will use the term "modern supply side economics" to describe the Biden Administration's economic growth strategy, and I'll contrast it with Keynesian and traditional supply-side approaches.

The American Rescue Plan, enacted into law in March 2021, ensured that aggregate demand would return the economy to full employment—which was appropriate at that time in response to the crisis. In this respect, the Biden strategy was similar to the "Keynesian approach" championed, for example, by the Obama Administration in the aftermath of the Global Financial Crisis and embodied in earlier stimulus packages enacted to combat previous downturns.

What we are really comparing our new approach against is traditional "supply side economics," which also seeks to expand the economy's potential output, but through aggressive deregulation paired with tax cuts designed to promote private capital investment. It is, unquestionably, important to properly implement regulation and maintain a pro-growth tax code, but they are not sufficient and can often be overdone. Modern supply side economics, in contrast, prioritizes labor supply, human capital, public infrastructure, R&D, and investments in a sustainable environment. These focus areas are all aimed at increasing economic growth and addressing longer-term structural problems, particularly inequality. The recently enacted Bipartisan Infrastructure Bill and the Build Back Better legislation that remains under consideration in Congress incorporate this modern supply side approach.

Our new approach is far more promising than the old supply side economics, which I see as having been a failed strategy for increasing growth. Significant tax cuts on capital have not achieved their promised gains. And deregulation has a similarly poor track record in general and with respect to environmental policies—especially so with respect to curbing CO2 emissions.

Moreover, this approach has deepened disparities in income and wealth by shifting the burden of taxation away from capital and towards labor. As Daron Acemoglu and Pascual Restrepo found, capital-based automation has also played a role—and perhaps the major role—in widening educational wage gaps between 1980 and 2016.

A country's long-term growth potential depends on the size of its labor force, the productivity of its workers, the renewability of its resources, and the stability of its political systems. Modern supply side economics seeks to spur economic growth by both boosting labor supply and raising productivity, while reducing inequality and environmental damage. Essentially, we aren't just focused on achieving a high topline growth number that is unsustainable—we are instead aiming for growth that is inclusive and green.

The economic moment is well-suited to accommodate such a modern supply side expansion. Potential GDP in the United States is constrained by a declining labor force. And with few exceptions, productivity growth has been sluggish since the late 1970s. We have underinvested in public infrastructure, and in education and training for children and all those who have not sought a four-year college degree. This underinvestment has widened the gap in earnings between highly skilled workers and those who lack a college degree—a gap that has relentlessly increased since the late 1970s.

Importantly, the Biden Administration's economic strategy embraces, rather than rejects, collaboration with the private sector through a combination of improved market-based incentives and direct spending based on empirically proven strategies. For example, a package of incentives and rebates for clean energy, electric vehicles, and decarbonization will incentivize companies to make these critical investments.

Let me now turn to three aspects of the Biden agenda that exemplify this modern supply side approach.

The first pertains to labor supply and is reflected in the Build Back Better agenda.

Labor supply has been a concern in the United States even before the pandemic, in part due to an aging population and in part due to a labor force participation rate that has trended downward over the past 20 years. Now COVID and declining immigration have further reduced the workforce. The lagging labor force participation rate is driven in large part by a combination of factors that disincentivize work, such as inadequate paid leave and high childcare costs.

While the final details of a package continue to be discussed by the Administration and Congress, the core of Build Back Better counters these trends by making it easier for working-age parents to participate in the labor market. It proposes two additional years of universal early childhood education along with expanded elder care. It seeks to cap childcare expenditures for most families at 7 percent of their income. And an expanded Earned Income Tax Credit is intended to provide greater economic security to households while incentivizing lower-income workers to seek employment. These programs should help to reverse the ongoing decline in the U.S. labor force participation rate relative to other developed countries and to boost potential GDP growth.

A second focus of the Biden agenda is to enhance productivity. Over the last decade, U.S. labor productivity growth averaged a mere 1.1 percent—roughly half that during the previous fifty years. This has contributed to slow growth in wages and compensation, with especially slow historical gains for workers at the bottom of the wage distribution.

There is a concern, however, that technological advancement that boosts productivity growth may exacerbate, rather than mitigate, inequality. This possibility is illustrated by the pandemic-induced surge in telework. A recent study forecasts that the gains from expanded telework will ultimately raise U.S. productivity by 2.7 percent.[1] Yet, those gains are not likely to be equally shared. Upper-income white-collar workers are likely to enjoy the largest benefit. Increased online learning is another pandemic induced technological shift that is likely to widen the educational achievement and productivity gap between upper-income children relative to those who are lower-income and minority.

The Biden Administration aims to boost labor productivity in ways that will help to address the disparities in wage growth. The focus is on enhancing the skills of workers—and particularly those with low incomes—to be able to take advantage of new technologies. To do this, we are proposing wide-ranging investments in human capital—from early childhood education to community college, apprenticeships, and worker training.

Additionally, long-overdue investments in infrastructure—such as broadband, as well as ports, roads, and rail—should benefit American families, workers, and businesses alike. At the same time, we are investing in new energy infrastructure and support for R&D to incentivize innovation in renewable energy technologies. These investments should promote sustainable growth by addressing climate change and mitigate extreme weather events, which also have disproportionate impact on the poor.

A third aspect of the Administration's supply side agenda relates to taxation.The current system of multinational taxation constricts supply by rewarding companies that shift real economic activity for tax-driven reasons, thereby discouraging efficient deployment of capital and undercutting fiscal resources that can fund supply expansions.

Over the past several decades the burden of taxation—in the United States and globally—has shifted away from corporations and onto the middle class. A significant reason for this shift is tax competition among nations. This competition has created a race to the bottom in corporate tax rates on footloose capital. In this competition, no country is a winner, and working and middle-class people around the world lose. Large multinational corporations have been incentivized to stash profits in their low-taxed subsidiaries around the world in tax-driven and inefficient transactions. This race-to-the-bottom thus depletes governments of the resources they need for the complex challenges they face. From the U.S. perspective, perverse corporate tax incentives have caused some companies to shift real economic activity beyond our borders, further contracting supply and reducing our nation's productive capacity.

This past summer, in a remarkable testament to the power of U.S. leadership and multilateralism, 137 countries—representing nearly 95 percent of the world's GDP—have agreed to rewrite the international tax rules to impose a global minimum tax on corporate foreign earnings.

This historic global tax deal will end this race to the bottom by ensuring that profitable corporations pay their fair share, providing governments with resources to invest in their people and economies. At the same time, it will level the playing field so that all multinational companies will face a minimum tax on their foreign earnings, rather than just U.S. companies. This new system will improve productivity by incentivizing businesses to allocate capital to its most productive use, rather than to the use that produces that best tax result. A more efficient allocation of capital via a more level playing field, achieved in a manner that improves fairness for workers, represents a win-win that aligns with the modern supply side approach.

Finally, the agreement will also stabilize the rapidly eroding international tax system by updating its rules to reflect a 21st century economy. The new rules recognize that a business can be meaningfully involved in the economic life of a country without necessarily being physically present there. They will replace a chaotic array of unilateral tax measures that countries enacted in response to growing dissatisfaction with the status quo, but that burdened an increasing scope of U.S. businesses with multiple layers of taxation, discriminated against them, and created trade tensions that threatened economic growth and investment. These new rules can provide much needed tax certainty and clarity to our businesses that will benefit them and their workers.

Let me further note that the Biden Administration's leadership in negotiating this multilateral tax agreement is emblematic of our larger commitment to multilateral collaboration. Global cooperation is vital to address the common challenges that all of us now face. The global nature of the pandemic epitomizes the intertwined fates of all of us on this planet. COVID demands a truly global response, as alleviating the virus within our borders requires fighting it abroad. Of course, climate change represents an existential threat that will require close global coordination and robust efforts by individual countries to reach their net zero commitments.

To conclude, many of us participating in this week's discussions have been centrally involved in economic policy for decades—navigating the expansions, the shocks, and the recessions. It is safe to say that this economic recovery is unlike any other we have seen in part because economic and health outcomes are so closely intertwined.

My economists at Treasury today are monitoring vaccination and health statistics in parallel to the latest economic indicators. Fortunately, we have brilliant medical professionals, scientists, and health policy experts working tirelessly to end the pandemic in our country and beyond.

Moreover, we, as policymakers and business leaders, now recognize that we must respond to the demands of our citizens to use this recovery to make our economies and the world a more sustainable, fairer place.

I am optimistic about the U.S. economic recovery. We have a clear path forward with the recently passed infrastructure package and the proposed Build Back Better plan. Together these policies will promote a modern supply side expansion that boosts long-term sustainable growth, protects the environment, and distributes expanding national income more equally. I am confident that we can beat this pandemic and move decisively down the path toward a more prosperous future.

[1] Why Working From Home Will Stick