

Remarks by Secretary of the Treasury Janet L. Yellen at Stanford Institute for Economic Policy Research's 2022 Economic Summit

March 4, 2022

As prepared for delivery

Let me start by thanking the Stanford Institute for Economic Policy Research, and especially Director Mark Duggan, for inviting me to participate in today's event. SIEPR has an impressive track record of supporting high-quality, impactful economic policy research, and it is an honor to be part of this organization's Economic Summit. It is a special privilege, too, to follow these remarks with a discussion with Professor John Shoven, whom I am fortunate to have known for over half a century.

While it is not the topic of my remarks today, I wanted to start out by just saying my thoughts continue to be with the people of Ukraine as they fight back against an unprovoked invasion of their homeland. The United States and our partners and allies have already leveled significant costs to the Russian economy and President Putin, and we will continue to do so if he furthers his invasion. I'm sure we may discuss this more in our conversation following my remarks, but this continues to be a top priority for President Biden and the entire Administration.

My remarks today will focus on economic disparities across communities and racial groups. I'll argue that targeted investments to address these disparities can not only mitigate growing inequality, but also propel sustainable macroeconomic growth.

My remarks will briefly document the extent of the dispersion across communities and race, before turning to a strategy I've termed "Modern Supply Side Economics" to frame how key aspects of the President's economic agenda can boost growth while addressing such inequality.

To start, I'll begin with the empirical fact that the U.S. economy is characterized by vastly divergent economic conditions across places.

While the relevant definition of "place" can depend on context—sometimes it can be a city, other times it's a neighborhood, or even a single building—the residents and workers who

populate these places endure wide variation in resources, opportunities, and standards of living.

And the magnitude of this variation is striking

Consider the gap in social and economic metrics between counties in the top and bottom quintiles, as calculated by economists Ryan Nunn and Jay Shambaugh. Looking across select years over the past two decades, they find that the median household income is just \$40,300 for the bottom quintile, compared to \$83,000 for the top.

The poverty rate was 22.7% for the bottom quintile, but only 8.1% for the top. Housing vacancy rates were 21.7% in the worst-performing quintile, but only 5.2% in the best. Others have found similar divergences in rates of opioid addiction, childhood poverty, and incarceration, to name a few.

Two specific metrics merit special mention given their outsized impact on the potential output of a local economy. One is educational attainment, which is a strong predictor of economic and social wellbeing across U.S. counties. Increases in educational attainment can explain roughly 11% to 20% of U.S. productivity growth in recent decades, according to a U.S. Department of Education report that examined the link between education and economic productivity.

A second important metric is participation in the labor market.

As economist Tim Bartik points out, labor force participation varies substantially across metro areas, with a participation gap of 9 percentage points between the 10th and 90th percentiles of the employment rate distribution – roughly equivalent to the difference between the 1st and 22nd place among OECD countries.

What emerges from these statistics is a portrait of an economy fractured by zip code, where economic resources are increasingly concentrated in the best-endowed areas, while the rest of the economy languishes—creating persistent income disparities.

Economists have identified plausible explanations for this geographic stratification.

One possibility is that it reflects the economics of agglomeration. The notion of agglomeration is that economic activity naturally clusters in close proximity due to transaction costs associated with distance and the spillover benefits of closeness. Yet – variation across places cannot be explained solely by agglomeration. And even if it could, that

would not excuse policymakers from seeking reforms to spread economic gains more broadly across the American landscape.

Just as we see variations in economic resources and outcomes across America's places, there are also persistent disparities across the racial spectrum. And of course, it is critical to note that place and race are deeply interconnected in the United States, due in large part to decades of harmful policies designed to maintain residential segregation between races.

Disparities by race rival disparities across place. In terms of education and wages, for example, Black and Hispanic workers lag behind their white counterparts on virtually every metric. The gap begins early in a person's life, with white students' math skills at kindergarten entry 0.5 standard deviations higher than Black students' and 0.7 standard deviation higher than Hispanic students' on average.

These disparities in educational attainment continue through higher education, with 35% of white adults earning a bachelor's degree or higher, compared to just 21% of Black adults and 15% of Hispanic adults. Large educational disparities, coupled with racial discrimination in the labor market and other factors, lead to marked variation in wages and lifetime earning potential. By the time workers have reached their peak earning years, the average wage of Black and Hispanic workers is 75% that of whites.

Gaps in wellbeing and preparedness extend well-beyond education and labor market experience.

Health disparities, for example, also begin early in life, and persist over the typical individual's lifespan. Black and Hispanic Americans face higher rates of child abuse, lead exposure, obesity in childhood, and chronic illness in adulthood, and endure more restricted access to quality medical care.

These factors not only affect wellbeing, they are also often correlated with wages and productivity in the labor market.

Disparities across people and places coexist with a macroeconomy that currently suffers from acute long-term growth challenges, despite strong short-term growth. Under President Biden's leadership, the U.S. economy has grown rapidly during the recovery from the pandemic, with GDP growing last year at the most rapid rate in 40 years.

But forecasters uniformly agree that growth over the next several decades will be sluggish, limited by slow productivity growth and an aging population that restricts growth in labor supply.

These facts suggest the need for a policy approach that fosters greater equity across places and races while, at the same time, propelling faster aggregate growth.

Enter Modern Supply Side Economics—a concept I laid out in a recent virtual address to the World Economic Forum.

Modern Supply Side Economics aims to expand our nation's economic potential through productivity-enhancing investments paired with policies to boost labor supply. In terms of the aggregate production function, this approach raises labor productivity through deeper physical capital—both public and private; higher human capital; and advances in science and technology.

In addition, tax-based incentives and pro-family labor policies are designed to increase labor force participation. Traditional supply side economics, in contrast, focuses largely on augmenting the stock of private capital through policies that lower the user cost of capital—mainly through tax cuts on investment.

In addition to its focus on this broader set of factors of production, Modern Supply Side Economics is concerned with the distribution of investments across sectors, people, and places.

Under the traditional approach, tax cuts that lower the user cost of capital typically initially benefit capital owners; the benefits are then spread more broadly if—and this is a contentious if—those cuts lead to broader investment.

This approach, however, can exacerbate long-standing disparities across place and race because the initial benefits typically accrue to capital owners—a small and highly concentrated group.

Then, if cuts in capital taxation do not promote broader investment in disadvantaged areas or in projects that benefit households of color, the traditional approach tends to worsen preexisting inequities.

The modern supply side strategy, by contrast, is focused on allocating investments in a more systematic and equitable way—ensuring that disadvantaged communities and racial groups receive an adequate share of investments in both physical and human capital. Indeed, it is an explicit feature of this approach that individuals and areas that have been subject to the underinvestment I described receive outsized consideration. Such an approach yields larger aggregate gains under the basic economic premise that returns to investment exhibit diminishing returns. In the context of investments in people, directing public resources to

children and to workers who have received less education and training can yield the largest bang for the buck—and a return that can last decades.

One example of the promise of the modern approach can be seen through initiatives that remove lead from public water systems—a signature investment by the Biden-Harris Administration that was included in the Bipartisan Infrastructure bill.

As research by economist Janet Currie and others has shown, lead exposure can cause cognitive impairment in children, including significantly lower math and reading comprehension scores—with children of color and families in disadvantaged communities more likely to experience exposure. While traditional supply side economics would be unlikely to address this concern, the modern approach recognizes the potential productivity boost that comes with better academic proficiency owing to cleaner water.

In addition to this commitment to install lead-free pipes nationwide, the President's economic agenda includes an array of ambitious proposals designed to expand the productive capacity of economy while promoting more inclusive growth.

For example, the agenda focuses on boosting labor force participation by raising effective wages and mitigating barriers to employment. In particular, it proposes an expansion of the Earned Income Tax Credit—which is projected to raise the after-tax wages for 17 million workers—along with family-friendly proposals, such as tax credits and subsidies to make childcare affordable for low- and middle-income households; paid leave for workers; and universal pre-k education for three- and four-year old children. It also proposes an ambitious program to improve public transit systems.

A key element of the President's agenda is to raise worker productivity through a collection of human-capital initiatives that would expand access to early child education, make college more affordable, strengthen worker training, and achieve universal broadband access. All told, these investments represent one of the most ambitious expansions in training and education in our nation's history—an investment program that would revitalize the preparedness of our nation's workforce.

The Administration has also made access to capital for disadvantaged communities a key component of its economic strategy. This includes the State Small Business Credit Initiative to generate capital for small business lending and investment, unprecedented expansions in investments for community and economic development programs, and a Green Energy Accelerator that would devote 40% of its resources to disadvantaged communities.

A critical component of the Biden agenda involves the targeting of investments to mitigate place- and race-based inequities. A sizable share of the President's child-care reform agenda flows through state programs to subsidize care for low-income families. Many of the President's housing reforms are directed at disadvantaged communities with deteriorating housing stocks or a dearth of affordable homes. Historically Black Colleges and Universities also receive billions in support through the President's agenda.

This targeting has two notable impacts. The first is that it promises to mitigate place- and race-based disparities that have plagued our economy for far too long.

The economics literature shows these impacts could be substantial. Take, for example, the proposed expansion in the Earned Income Tax Credit, or EITC, for childless adults. This expansion is means-tested and thus highly progressive across the income distribution. The EITC, however, also has outsized impacts for racial minorities, owing to the relatively high prevalence of low-income Black households and the Credit's ability to impact Black workers' labor market participation. Looking at the impact of the EITC since its inception, recent research by Bradley Hardy, Charles Hoyakem, and James Ziliak found that the EITC significantly closed racial income disparities across much of the income distribution.

A second potential impact of targeting is its potential to meaningfully boost aggregate economic growth. For example, Mary Daly and co-authors simulate the economic production surrendered to racial inequity over the past three decades and find that more equitable education and labor market inclusion would annually add 760 billion to the economy. And while it would be unreasonable to suggest that any single reform package would fully equalize labor market outcomes for white and non-white workers, this calculation is suggestive of meaningful gains.

Further evidence of the growth-boosting potential of targeted investments to reduce place and race-based inequality comes in a recent paper by Chang-Tai Hsieh, Erik Hurst, Pete Klenow, and Chad Jones. These researchers estimate that between 20% to 40% of gains in economic output between 1960 and 2010 can be explained by inclusion of women and racial minorities in highly skilled occupations, such as the rising share of non-white doctors.

In conclusion, I'll note that the link between greater equity and stronger growth is one of the reasons the Biden-Harris Administration's economic agenda embraces racial equity as a core component.

Of course, there is no greater American ideal than providing equal opportunity regardless of race; this moral imperative is given voice in the Declaration of Independence and protected in the Constitution. But as a purely economic matter, righting inequities is also one of the most promising growth strategies we have in our toolbox.

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