Economic Impact of Closing the Minority Earnings Gap

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Background

There is a substantial earnings gap between non-Hispanic whites and persons of color in the U.S. that applies to males and females across all ages.[1] This earnings gap exists when consideration is limited to working individuals[2] but is even larger when those with zero earnings are included.[3] Much of this earnings gap can be explained by gaps in education and health that, in turn, are impacted by the earnings gap from earlier generations. Children born to families with very low earnings will, on average, grow up with less education, poorer health, and lower earnings potential. Thus the cycle of poverty continues from generation to generation.

Cycles of poverty not only cause suffering for entrapped populations. They also rob the nation of the contributions that these populations would make if they were to achieve higher levels of health, education, productivity and earnings. Among these contributions would be stronger economic growth and an improved ability for the nation to afford programs such as Medicare and Social Security that provide for our aging population.

In this paper, we quantify certain economic benefits associated with eliminating the earnings gap between non-Hispanic whites and persons of color. In this thought experiment, the gap is eliminated by raising average earnings of persons of color up to that of non-Hispanic whites by age and sex.[4] It is assumed that this elevation in earnings is accomplished through higher levels of productivity achieved through improvements in factors such as education and health. Thus, the higher earnings reflect increased economic output and, therefore, higher gross domestic product (GDP). The economic benefits that we estimate in the paper are linked to this increase in GDP.

Discussion begins with estimation of the earnings gaps. We then derive estimates of the economic impact of gap elimination.

Data and Methods

Our data source was the 2011 American Community Survey (ACS), a 1 percent sample of the US population. We divided the sample into two categories: non-Hispanic whites and all others (which we refer to as persons of color). To compute average earnings by age and sex, we first computed the population sizes by age and sex. These population counts include everyone, regardless of whether they have any earnings and whether they are institutionalized (e.g., incarcerated).

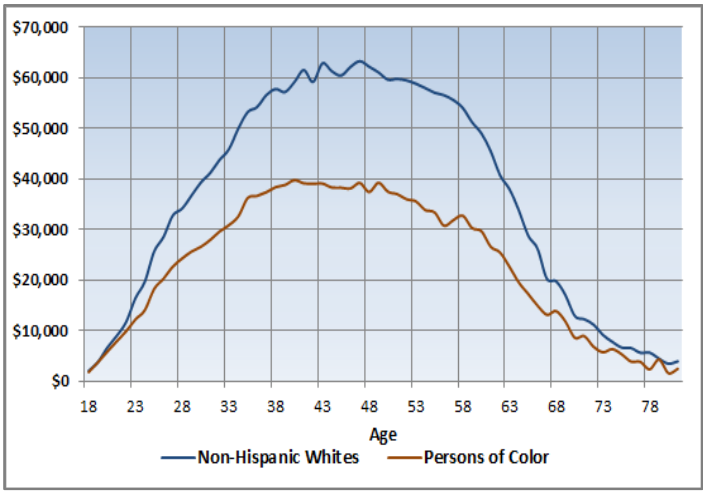
Next we added up all earnings, by age and sex, including wages, salaries, and self-employment income. Average earnings were then computed as the ratio of total earnings to total population for each age-sex combination.[5] This was done separately for non-Hispanic whites and persons of color.

Findings

Average earnings, by age, are plotted in the charts below, first for males and then females. The same scale is used to ease comparisons between charts. The earnings gap for males is larger than for females. Between ages 40 and 60, the male gap averages about $23,000, more than three times the female gap, which averages about $7,000. The male gap represents an earnings advantage of over 60 percent for non-Hispanic whites within this age group. For females, the advantage is about 30 percent.

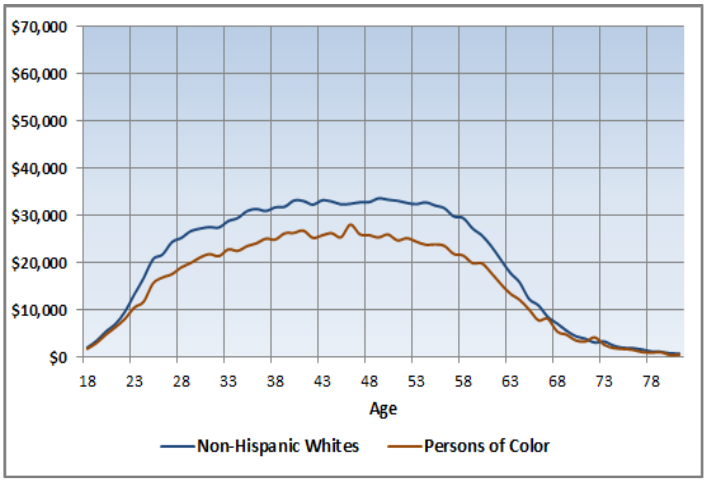
Looked at another way, earnings for persons of color are 30 percent below those of non-Hispanic whites after adjusting for age and sex. For males, this figure is 35 percent and for females it is 22 percent.

Figure 1: Earnings per Capita by Age for Males



Source: 2011 American Community Survey data.

Figure 2: Earnings per Capita by Age for Females



Source: 2011 American Community Survey data.

Economic Implications

In 2012, persons of color represented 37 percent of the working age population, defined here as ages 18 to 64. According to the latest population projections from the U.S. Census Bureau, this figure will rise to 46 percent by 2030 and 55 percent by 2050. These projections show that solving the earnings gap will become more and more important for our economic growth in the coming decades. Specifically, if age-sex specific earnings for persons of color were increased to that of non-Hispanic whites, total earnings in the U.S. would have been 11.8 percent higher in 2012. By 2030, elimination of the earnings gap would mean 15.8 percent higher earnings in the economy, and by 2050 this figure rises to 19.8 percent.

Suppose that the earnings gaps are eliminated through increases in productivity brought about by eliminating other gaps such as those in education and health.[6] Then the increased earnings will represent increased productivity and higher levels of gross domestic product. The table below presents some implications under the assumption that GDP grows in proportion to earnings.[7]

Table 1: Impacts of Earnings Gap Elimination: 2012, 2030, and 2050 ($ billions)

	With Gaps	Gaps Eliminated	Dollar Impact	Percent Impact
2012				
GDP	15,685	17,542	1,857	11.8%
Earnings	8,137	9,100	963	11.8%
Profits	1,525	1,705	181	11.8%
Federal Tax Revenues	2,470	2,763	293	11.8%
Federal Medicaid + Income Support	610	549	(61)	-10.0%
Deficit Reduction			353	
as percent of GDP			2.3%	
2030				
GDP	34,300	39,727	5,427	15.8%
Earnings	18,353	21,257	2,904	15.8%
Profits	2,833	3,282	448	15.8%
Federal Tax Revenues @19% of GDP	6,517	7,548	1,031	15.8%
Federal Medicaid + Income Support	975	877	(97)	-10.0%
Deficit Reduction			1,129	
as percent of GDP			3.3%	
2050				
GDP	82,300	98,593	16,293	19.8%
Earnings	44,038	52,756	8,718	19.8%
Profits	6,798	8,144	1,346	19.8%
Federal Tax Revenues @19% of GDP	15,637	18,733	3,096	19.8%
Federal Medicaid + Income Support	2,338	2,104	(234)	-10.0%
Deficit Reduction			3,330	
as percent of GDP			4.0%	

Elimination of the earnings gaps in 2012 would have raised GDP by about $1.8 trillion and corporate profits by $178 billion. Federal tax revenues would have increased by $288 billion. We did not attempt to quantify the reduction in federal Medicaid spending and income support expenditures. Instead we used a conservative estimate of a ten percent reduction as persons of color

move out of poverty as earnings gaps are eliminated. This would reduce federal spending by $61 billion. The net effect would be to reduce the federal deficit by about $349 billion or 2.2 percent of GDP.

These effects increase over time as persons of color increase as a share of the working age population. By 2050, elimination of the earnings gap would increase GDP by $16.3 trillion, close to a 20 percent increase. This would add an average of 0.5 percent annual growth to GDP between 2012 and 2050. It would also reduce the deficit by $3.3 trillion, which is 4.0 percent of GDP.

Limitations

This study focuses on the economic benefits associated with eliminating the earnings gaps between non-Hispanic whites and persons of color. It does not address the question of how this would be accomplished nor the associated investments that would be required. However, the huge potential benefits shown serve a useful purpose in terms of justifying substantial investments in programs that have been shown to be effective in reducing the gaps.

It is also important to recognize that the estimates in this study represent a hypothetical upper bound and leave many questions unanswered. An example, already noted, concerns the degree to which earnings gaps are due to unequal pay for equal productivity. Elimination of this portion of the gap would improve equity but would not impact real GDP. Another question is the extent to which the economy can accommodate a significant increase in the average skill level of the workforce. Might some portion of the more highly trained persons of color simply represent increased competition for high paying jobs, thus producing winners and losers? While there may be some winners and losers, it is worth noting that the economy has been evolving in the direction of needing a more highly skilled workforce. Thus the predominant impact of a more highly skilled workforce should be an increase in real GDP and the number of high-paying jobs.

Given these unanswered questions, the best way to use these estimates is as an upper bound from which to consider more realistic scenarios. For example, what if we could only achieve half of the benefits estimated here? How much should we be willing to invest? More precise estimates await additional research but we can be sure that the potential benefits are enormous. Put another way, the potential costs of inaction are correspondingly large.

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[1] The term "persons of color" refers, in this brief, to everyone other than non-Hispanic whites. The earnings gap differs across the many racial/ethnic groups that make up persons of color. For present purposes, we treat persons of color as a single homogeneous group and leave the interesting questions about subgroups to future research.

[2] Center for American Progress/PolicyLink, *All-in Nation*. July 2013.

[3] Persons of color are more likely to have zero earnings. Those in the labor force are more likely to be unemployed and there is also a higher fraction not in the labor force for various reasons such as poor health and incarceration.

[4] The definition of average earnings includes those with no earnings.

[5] The survey was large enough to permit computation by individual age, from 18 to 95.

[6] We recognize that, in reality, some of the earnings gaps are due to unequal pay for the same level of productivity. Elimination of this portion of the earnings gap would improve equity but leave GDP unchanged. We do not know how much of the earnings gap falls into this category.

[7] This is equivalent to assuming that the earnings share of GDP remains the same. GDP projections are from *The 2012 Long Term Budget Outlook*, Congressional Budget Office (CBO), June 2012. Earnings and profit shares of GDP are from the Bureau of Economic Analysis, *Table 1.10 Gross Domestic Income by Type of Income*, June 26, 2013. Projected shares are based upon observed shares in 2007, the most recent full-employment year. Tax revenues as a share of GDP for 2012 are from *The Budget and Economic Outlook, Fiscal Years 2013 to 2023*, CBO, February 2013. For 2030 and 2050, the tax revenue share of GDP is set to 19 percent which is in line with CBO ten year projections.

This study was funded by the W. K. Kellogg Foundation.