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Achieving a more equitable and inclusive economy is one of the most important priorities of our time. Before the COVID-19 pandemic, and despite the longest economic expansion in US history through much of the 2010s, the United States has been experiencing record levels of economic inequality. As our country continues to deal with a pandemic that has disproportionately affected the lives and livelihoods of women, people of color, low-income workers, and other vulnerable groups, the need for a more inclusive growing economy could not be more pressing. Contrary to fears that economic inclusion must come at the expense of economic growth, our research supports the idea that economic growth is at its best when it is most inclusive. Conversely, left unaddressed, inequality and economic exclusion threaten economic growth. By embedding equity into the development process and improving opportunities for those on the margins to meaningfully participate in the mainstream economy, we can push forward a more sustainable and equitable economy. Together, public-, private-, and social-sector leaders can work with communities to bring about the transformative change that creates an economy that works better and benefits everyone.

Bob Sternfels
Senior Partner,
McKinsey & Company
The case for inclusive growth

US leaders across sectors have an opportunity to improve economic performance—and bolster individual and community well-being—through investments that embed equity into the development process.

by André Dua, JP Julien, Mike Kerlin, Jonathan Law, Brenden McKinney, Nick Noel, and Shelley Stewart III
The concept of inclusive growth has become central to economic development. Inclusive growth aims to achieve economic growth by raising living standards and reevaluating who participates in the economy and how. From the United Kingdom’s Inclusive Growth Commission to Oxfam’s efforts with the Asia-Pacific Economic Cooperation Summit to initiatives undertaken by city governments in the United States, such as San Diego, organizations across the globe are accelerating their inclusive growth agendas.
Inclusive growth has gained traction as an explicit goal of economic development due to rising wealth and income inequality (or economic inequality) and its effects on human well-being and prosperity—that are increasingly unmistakable and unsustainable. Indeed, socioeconomic disparities are devastating, persistent, and growing. Since the early 1970s, a persistent gap has existed between worker compensation and overall economic productivity. And despite the longest economic expansion in US history through much of the 2010s, the Gini index reached 0.485 in 2018—the most inequitable level of income distribution recorded in the United States since the Census Bureau began tracking the metric, and the highest level of income inequality among Group of Seven countries. More important, the bottom 50 percent of American families have experienced a net decrease in wealth and income since 1989. These wealth and income disparities drive stark divides in mental and physical health outcomes, among other outcomes, with low-income individuals reporting sadness, worthlessness, or hopelessness six to ten times more often than high-income individuals and dying six years earlier than high-income individuals, on average.

The lack of economic inclusion has disproportionately affected racial and ethnic minorities, women, and certain geographies. For example, between January 1972 and December 2019, other than during the aftermath of recessions, the unemployment rate for Black workers has stayed at or above twice the rate for white workers. According to the US Census Bureau, three out of four single parents in the United States are mothers, and 60 percent of these families headed by mothers are living below the poverty line. Moreover, recent research reveals a growing gap between advantaged and disadvantaged neighborhoods, with fewer than 40 percent of Americans living in middle-class neighborhoods. As a recent economic report put it, the “US economy is delivering a humbling lesson about economic development: top-line growth doesn’t ensure bottom-line prosperity.” Geographically, previous McKinsey analysis revealed that 50 “superstar cities” account for 21 percent of the world’s GDP. The average GDP per capita in these cities is 45 percent

“Economic growth should be distributed fairly across society and [so] should opportunities for all.”

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higher than that of peers in the same region and income group, and the gap has grown over the past
decade, leading to increased inequality across regions. Eleven of these superstar cities are in the United
States, concentrated on the coasts, furthering economic inequalities among US regions.\textsuperscript{13}

Aside from inequality’s negative impact on human well-being and prosperity, it also poses a threat to long-
term economic growth: there is evidence that it pushes down aggregate demand and causes underinvestment
in human capital, damaging productivity by shrinking innovative capacity. Our prior research highlighted
that shrinking disparities in wealth between Black and white households could result in the addition of
$1.5 trillion of incremental annual GDP to the US economy, and closing the wealth gap between Hispanic
and Latino Americans and white Americans could result in more than $1.3 trillion of added incremental
annual GDP.\textsuperscript{14} Furthermore, unlocking women’s economic potential in the workforce over the coming years
could add $2.1 trillion in GDP by 2025.\textsuperscript{15}

Growing inequality and dissatisfaction with the status quo have increased demand for a more inclusive
economy; however, the ability to reliably produce inclusive growth outcomes remains elusive. That said,
achieving a more inclusive economy is now more important than ever. COVID-19 has accelerated trends that
existed before the pandemic, and without a more inclusive recovery plan, existing disparities may
further calcify. More than 70 million Americans—approximately 40 percent of US workers—applied for
unemployment benefits between the start of the pandemic and the end of 2020.\textsuperscript{16} And the US economy
contracted by 3.5 percent on an annual basis in 2020 alone and may take several years to recover.\textsuperscript{17}

Given this reality, it is our belief that long-term, sustainable, and inclusive growth will be impossible without
actively embedding equity in the development process. The report that follows answers three fundamental
questions: What is inclusive growth? Why do growth and inclusion reinforce each other? And how might
leaders across sectors better work together to achieve it?

Common ground: What is inclusive growth?

At its most fundamental level, inclusive growth is concerned with the pace of economic growth and how
the benefits of economic growth are distributed. More specifically, inclusive growth seeks to address
the level of economic prosperity in the economy and how resources are allocated and distributed, both today
and in the future (see sidebar “Economic indicators that can be used to measure current and future
prosperity and distribution”).

Economic indicators that can be used to measure current and future prosperity and distribution

The following are among the indicators that can be used to track prosperity and resource distribution:

<table>
<thead>
<tr>
<th>Current prosperity</th>
<th>Future prosperity</th>
<th>Current distribution</th>
<th>Future distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP, GDP per capita, total income per capita, and wealth</td>
<td>GDP growth, GDP per-capita growth, and median income growth</td>
<td>Share of total income by decile, quartile, or quintile; poverty rate; Gini index; and wealth Gini coefficient</td>
<td>Intragenerational mobility, intergenerational mobility, and wealth transfers</td>
</tr>
</tbody>
</table>
We engaged a panel of more than 50 public-, private-, and social-sector practitioners, leaders, and experts across the United States to understand how they think of inclusive growth. While different stakeholders emphasized slightly different aspects of what inclusive growth means, there was broad alignment on its fundamental definition and goals.

When asked to define inclusive growth, "growth that seeks to broadly benefit all members of society" resonated with the most panelists (Exhibit 1). When asked to "choose the outcome that most closely aligns with the overall objective of inclusive growth," 62 percent of respondents stated that inclusive growth should aim to "improve economic outcomes for all people, equally (e.g., groups share benefits equally)," compared with 36 percent of respondents who stated that the goal of inclusive growth is "primarily improving economic outcomes for the least well-off (e.g., poorest)" (see sidebar “In their words: What should inclusive growth seek to achieve?”).

That said, when asked to identify the best ways to assess inclusive growth, experts placed greater emphasis on reducing inequality and increasing access to opportunity between groups (Exhibit 2). Among six possible outcomes (ranging from those with a greater emphasis on absolute gains to those with relative gains), experts agreed that measuring relative performance was better in assessing inclusive growth. Notably, 81 percent of respondents ranked “income inequality/share of total income” among the three best ways to assess inclusive growth, compared with just 28 percent of respondents who ranked “absolute average income” in their top three. These viewpoints reflect the multiple, simultaneous ambitions of practitioners engaged in this work—achieving outcomes that benefit all segments of society while also recognizing the need for supporting those on the margins and reducing relative inequality.

Informed by these discussions, leading development research, and work across communities in the United States, we posit that inclusive growth involves both process and outcome. It is about aligning how growth is achieved (or how people are provided access to opportunities) with the ultimate outcome of broad, shared prosperity (that is, decent living standards that increase with economic growth).

In their words: What should inclusive growth seek to achieve?

The practitioners, leaders, and experts in our study had varying—but related—views on what inclusive growth should aim to achieve:

- “Economic growth should be distributed fairly across society and [so] should opportunities for all.”

- “Growth across different segments of the population that doesn’t leave behind vulnerable groups [such as] women, Indigenous peoples, communities of color, etc.”

- “Providing the opportunity for all sections of society to participate in economic growth.”

- “As our city saw exponential growth over the years, it became clear that many populations were left out and suffered as a result of the economic growth the region experienced—many weren’t able to compete, participate, or share in the success.... Inclusive growth is not only including everyone but providing equity and ownership to share in the success of the region.”

- “Economic growth that benefits everyone and, particularly, provides bigger benefits for those near the bottom of the economic ladder.”
Exhibit 1

Panelists showed broad alignment on the meaning of inclusive growth.

**Agreement with definitions of inclusive growth,** % of respondents who answered “strongly agree” or “somewhat agree” to the following prompts

<table>
<thead>
<tr>
<th>Definition</th>
<th>Strongly agree</th>
<th>Somewhat agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic growth that seeks to broadly benefit all members of society</td>
<td>64</td>
<td>25</td>
</tr>
<tr>
<td>Economic growth that seeks to reduce economic inequalities between groups</td>
<td>57</td>
<td>26</td>
</tr>
<tr>
<td>Economic growth that seeks to benefit vulnerable populations the most</td>
<td>28</td>
<td>42</td>
</tr>
</tbody>
</table>

1Question: To what extent do you agree with the following definitions of inclusive growth? Source: Economic development expert survey, n = 53, November 2020

Exhibit 2

Experts agreed that the best way to assess inclusive growth is to measure relative performance.

**Metrics best suited to inclusive growth,** % of respondents who selected these metrics as the first, second, or third best way to assess inclusive growth

<table>
<thead>
<tr>
<th>Metric</th>
<th>First rank</th>
<th>Second rank</th>
<th>Third rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income inequality/share of total income</td>
<td>23</td>
<td>28</td>
<td>30</td>
</tr>
<tr>
<td>Levels of economic mobility</td>
<td>23</td>
<td>32</td>
<td>21</td>
</tr>
<tr>
<td>Individual well-being (eg, economic, social, health)</td>
<td>36</td>
<td>21</td>
<td>19</td>
</tr>
<tr>
<td>Absolute average income</td>
<td>8</td>
<td>8</td>
<td>13</td>
</tr>
<tr>
<td>Absolute job gains</td>
<td>8</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>GDP/GDP per capita growth</td>
<td>4</td>
<td>2</td>
<td>9</td>
</tr>
</tbody>
</table>

Note: Figures may not sum, because of rounding.

1Question: In your opinion, which of the following metric(s) are best suited to measure ‘inclusive growth’? Rank metrics from 1 (best suited to measure level of inclusive growth that a region experiences) to 6 (least well suited) Source: Economic development expert survey, n = 53, November 2020
Why do growth and inclusion reinforce each other?

The perceived tension between inclusion and growth—and the false belief that they should be addressed separately—has hampered efforts to pursue and achieve inclusive growth. But there are both economic and moral reasons that the two should be tackled together.

The economic case

Insufficient economic inclusion is a threat to prosperity, and it is difficult to improve economic mobility and resource distribution without increasing the overall size of the economy (Exhibit 3). Indeed, the concept of inclusive growth suggests that economic growth is at its best when it is most inclusive. However, social and economic forces have created macroeconomic imbalances that have put a wedge between growth and inclusion, producing inequitable concentrations of wealth and income. Research shows that this inequality threatens to be self-perpetuating as living standards and social mobility stagnate, leaving many populations in a vicious cycle of underdevelopment that threatens long-term growth for everyone. Families and communities aren’t able to make investments in their children and their physical and social environments, creating barriers to human and place-based development that thwart access to opportunities. In turn, this limits the ability of these groups to participate in growth processes, and, worse, their environments are left without the ingredients to build momentum and reverse these dynamics.19

Exhibit 3

Increases in both prosperity and resource distribution are required for inclusive growth.

Changes in prosperity and resource distribution

Inclusive growth has gained traction as an explicit goal of economic development due to wealth and income inequality and the effects on human well-being and prosperity.
As such, equity-and-inclusion practices are needed so families can maintain equal access to economic opportunities and so they can see their living standards grow as the economy expands. Otherwise, the long-term trend of increasing economic inequality may continue.

Furthermore, the shortage of qualified talent in large, fast-growing, and specialized sectors—from healthcare and technology to transportation—is holding back not just those sectors but the entire economies that those sectors underpin. With relatively slow population growth of less than 1 percent per year, the US economy can only grow specialized talent by training and retraining more people. The largest pools of undertrained workers can be found in communities of color. Closing just half the gap in college-degree attainment between Black and Hispanic individuals and non-Hispanic white individuals would put more than five million more college-degree holders into America’s workforce. And creating opportunities in science, technology, engineering, and mathematics (STEM) and skilled trades for these communities could eliminate the talent gaps holding back national and local economies. In this context, it is not surprising that some of the largest searches for corporate headquarters locations in recent decades have evaluated regions less on economic incentives and more on the breadth and depth of diverse talent and diverse talent pipelines in those regions.

Inequality places productivity constraints not just on talent-driven growth but also on innovation- and entrepreneurship-driven growth. Only 2 percent of venture-capital dollars flowed to all-women founder teams, and only 1.0 percent and 1.8 percent of venture-backed founders were Black or Hispanic, respectively, as of 2017. Research suggests that up to 40 percent of GDP growth in the US economy between 1960 and 2010 can be attributed to greater participation of women and people of color in the labor force through improved talent allocation. Indeed, research shows that economies grow faster and more vigorously—not to mention for longer periods—when prosperity is more equally distributed across segments of the population: And practitioners agree on the importance of inclusion to fuel growth: 98 percent of the economic-development practitioners, leaders, and experts we consulted strongly or somewhat agreed that “economic growth is improved or increased by greater inclusion in the economy of different groups.”

Facing the largest economic retraction since the Great Depression, the United States must find ways to improve participation to unlock growth and ensure an effective economic recovery. Of the practitioners we consulted, 72 percent said that inclusive growth is “of the utmost importance” given America’s current economic reality.

The moral case
There is an urgent need for inclusive growth given that the pandemic has amplified a great divergence in economic opportunity and outcomes, with different demographic groups—across, for example, race, gender, and geography—experiencing outsize negative consequences.

— **Race or ethnicity.** The racial wealth gap between Black and white households grew from $100,000 in 1992 to $164,100 in 2019. The gap is similar between Hispanic or Latino and white households ($152,100 in 2019). This wide and persistent gap is likely to increase as a result of the COVID-19 crisis. Black workers are more vulnerable to job loss and furlough: 39 percent of all jobs held by Black Americans are at risk, compared with 34 percent of those held by white workers. And a spring 2020 survey revealed that 57 percent of Hispanic households reported lost jobs or income due to the pandemic, compared with 41 percent of Black households and 38 percent of white households.
There is an urgent need for inclusive growth given that the pandemic has amplified a great divergence in economic opportunity and outcomes.

— **Gender.** In December 2019, women made up a slight majority of the US workforce—the highest share in a decade. But in March 2020, women accounted for 60 percent of job losses; in December 2020, the United States lost 140,000 jobs—100 percent of which were held by women. Closures of schools and day-care centers have also increased childcare needs, which regrettably fall disproportionately on women and have a large impact on working mothers and families.

— **Income and educational background.** Historically, the unemployment rate has been persistently higher for groups with lower levels of education and groups with lower-income earners. In January 2020, the unemployment rate for individuals with less than a high school diploma was 5.5 percent, compared with 2.0 percent for those with a bachelor’s degree or higher. Now, in the midst of a crisis, industries with the lowest wages and educational attainment are being hit hardest. Approximately 86 percent of the initial impact of the pandemic affected jobs that were paying less than $40,000 per year. The most vulnerable jobs are in the accommodation and food services industry, as well as in retail, which requires the lowest percentage of bachelor’s degrees.

— **Geography.** A growing body of research highlights that geography and place are critical in shaping economic outcomes. In 2015, the poverty rate in rural areas was 17 percent, compared with 11 percent in suburban areas. The rural job market is still 4 percent smaller than it was in 2008, while the metropolitan job market has grown 4 percent larger. McKinsey research also highlights that more than two-thirds of US job gains since 2007 have been concentrated in 25 cities. We also know that place greatly affects the levels of economic mobility that children experience.
— **Physical and mental ability.** In 2015, the median income for people with a disability was 30 percent lower than workers without a disability.34 The employment rate in 2017 for people with any physical or cognitive disability was 36 percent and 27 percent, respectively, compared with 75 percent for those without disabilities.35 According to the World Health Organization, people with disabilities are affected more by COVID-19 because of factors including underlying health conditions, barriers to healthcare access, and difficulty physical distancing due to support needs.36

— **Sexual orientation.** Before the pandemic, LGBTQ+ residents faced higher rates of poverty than their non-LGBTQ+ counterparts—at 21.6 percent compared with 15.7 percent—despite similar levels of employment.37 Now, LGBTQ+ individuals are at greater risk from both the health and social effects of the pandemic, as they are more likely to experience discrimination in healthcare; have chronic health conditions; and work in the food-service, restaurant, and entertainment sectors. Older LGBTQ+ adults also experience higher rates of social isolation.38

— **Immigration status.** Undocumented immigrants in the United States earn up to 40 percent less per hour than native-born workers in comparable roles, despite paying an estimated $11.6 billion annually in state and local taxes across the country.39 As a result of this earnings discrepancy, this population is nearly twice as likely as the general US population to be food insecure (24 percent compared with 14 percent).40 The ramifications on human well-being are severe, as this population’s undocumented status excludes them from support programs such as the Supplemental Nutrition Assistance Program, Temporary Assistance for Needy Families, and additional pandemic-related funding.41

Importantly, these segments of the population don’t exist in isolation. Rather, the intersection of characteristics (for example, being a Black woman or being a low-income resident living with a disability) often reinforces challenges and amplifies economic exclusion.
Unlocking inclusive growth via the four social systems that influence human well-being and drive economic activity and participation

Our research and experience highlight that economic performance—the absolute size, growth, and nature of GDP and income in the economy, as well as who participates and benefits from this performance—is embedded within four interconnected social systems that influence human well-being and drive economic activity and participation: community and institutions, human development and consumption, private-sector development and innovation, and financial development and transfer systems (Exhibit 4). Social and economic disparities that come out of these systems are the result of barriers embedded across key macro journeys. These barriers stem from adverse determinants (such as policies, cultural attitudes, and geospatial arrangements) that generate damaging ripple effects and entrench economic underperformance (for a case study on specific barriers associated with this process, see sidebar “An inclusive home-buying and homeownership journey”).

Private-sector development and innovation

Equitable private-sector development aims to provide access to and support for key journeys and opportunities navigated primarily by business and real-estate owners and industries by investing capital to unlock productive outputs for the economy. These journeys drive economic output; they include opportunities to pursue entrepreneurship, own private assets, and access business supports and capital.

Exhibit 4

Economic participation and productivity occur within four systems that drive individual and community well-being.

Individuals and families interact with these economic systems in different ways

1. **Private-sector development and innovation**
   - Systems that support investment, innovation, and business activity for entrepreneurs and business owners

2. **Human development and consumption**
   - Systems that govern workers and consumers, driving productive and resilient human capital

3. **Financial development and transfers**
   - Financial and resource-allocation systems that support savers and investors

4. **Community development and governance**
   - Supporting systems, rules, and norms that enable well-balanced development for residents
as well as opportunities for firms and sectors to develop and diversify (for example, to improve profitability by participating in supply chains and hiring skilled workers). However, economic output cannot be the sole metric for measuring progress. For example, to reach parity in the entrepreneurial journey and produce equitable profits between Black and white entrepreneurs in the private sector, we must focus on decreasing the participation gap between Black and white business owners, while also decreasing the gap in average revenues and profitability between Black- and white-owned businesses.

The relationship between economic growth and inclusion in the private sector is particularly clear in three opportunity areas:

— **Business formation and performance.** Improving business formation in underinvested communities can help support and create new business clusters for continued innovation while creating new centers of job creation. McKinsey research has shown that equitable access to capital—through providing minority-owned small and medium-size businesses (SMBs) with capital they need to operate—has the potential to add billions of dollars to the economy. It can also spur further economic growth by creating a multiplier effect that reverberates throughout communities across the United States. Adding an additional $7.6 billion to $15.4 billion in liquidity for Black-owned SMBs from 2020 to 2021—less than 3 percent of the $659 billion authorized under the Paycheck Protection Program—could preserve 460,000 to 815,000 jobs. Increasing the availability of financial resources for Black entrepreneurs—particularly start-up and expansion capital—will be crucial to improving business owners’ experiences and replenishing the pipeline of start-up and growth businesses over time.

— **Business scale-ups.** Given the significant inequality in venture-based entrepreneurship laid out above, it could be argued that the United States is achieving only around one-third of its innovative potential. If more than 90 percent of venture-backed entrepreneurs are white and Asian men, that means that the United States is losing out on the innovative potential of most female, Black, and Latino entrepreneurs. Some private and public seed- and venture-capital players have stepped up to provide targeted funding to women and underrepresented racial and ethnic entrepreneurs. For example, the Black Economic Development Fund recently raised $175 million of capital to invest in Black-led financial institutions and support business transactions to strengthen the Black community. Goldman Sachs has also made a pledge to commit $10 billion over ten years to advance racial equity and economic opportunity for Black women.

— **Unmatched demand for jobs.** McKinsey research has uncovered an abundance of talent gaps within the economy. A focus on closing these gaps in an inclusive manner would spur both more sustainable economic growth and more equitable outcomes for workers. According to a 2020 McKinsey Global Survey on workforce needs, nearly nine in ten executives and managers say their organizations either face skill gaps already or expect gaps to develop within the next five years. Respondents in financial services, high tech, and telecom were most likely to expect this level of disruption. In a forthcoming report with the McKinsey Global Initiative, McKinsey shows that approximately 61 percent of the total aggregate wage gap between Black and white Americans could be accounted for by closing the representation and wage gaps within less than 4 percent of occupations—many of these being in the industries expecting the highest rates of talent gaps.
Human development and consumption
Equitable human development aims to address the hierarchy of needs that must be met for residents and workers to fully participate in the economy and have individual well-being. The journeys embedded here include opportunities for residents to be healthy, develop skills and expertise, and access the labor market so that they can be productive and resilient actors in the economy and power economic growth. For workers, a major determinant of well-being and a cause of inequality is wages. To decrease the wage gap between Black and white workers, we need to focus on both inclusion and performance factors. For inclusion, it will be imperative to increase the number of Black workers in the workforce by both improving outcomes such as the labor-force participation rate and enhancing education and skill attainment levels to allow more people to join the workforce. At the same time, increasing workers’ time in the workforce by focusing on key outcomes such as the unemployment rate and the underemployment rate, while also focusing on the average wages of these workers, will be equally important to unlock performance.

The following are two opportunities in human development to capture increased economic growth by improving inclusivity:

— Investment in human capital. Automation has the potential to severely widen the racial wealth gap. But there is an opportunity for interventions to help Black workers reskill and prepare for the future in more economically productive roles. Previous McKinsey analysis that overlaid racial representation and automation assessments of nearly 2,000 different work activities in more than 800 occupations found that Black workers are disproportionately concentrated in the kinds of support roles most likely to be affected by automation. But this analysis also discovered that retraining in just five occupation categories at the highest risk for automation would mitigate nearly 60 percent of the risk to the African American workforce. Collaboration across the private, public, and social sectors to retrain workers at risk of displacement can drive higher productivity for retrained workers while reducing inequality.

“Collaboration across the private, public, and social sectors to retrain workers at risk of displacement can drive higher productivity for the retrained workers while reducing inequality.”
— **Access to high-quality or preferred goods and services.** Inadequate access to high-quality goods and services is holding back growth, innovation, and consumer experiences for a rising consumer class in Black and Latino communities. McKinsey determined that, compared with white residents, a higher percentage of Black residents live in census tracts designated as “consumer deserts” across each category we measured: food, housing, banking, broadband internet, healthcare, and consumer goods. These six categories account for 72 percent of the average Black household’s consumption. Yet, on average, counties with above-average Black populations have fewer grocery stores, restaurants, and farmers’ markets, and more convenience stores. Serving these demographics and erasing the discrepancies in access could uncover enormous growth potential for the private sector, as well as improve customer experiences and resident satisfaction.

**Financial development and transfers**

Financial and transfers systems give individuals and communities access to financing and resource-allocation systems that reduce economic volatility. The development of financial and resourcing systems aims to create economic savings while redistributing capital equitably and efficiently. The journeys in this process include the degree to which families, businesses, and communities have access to financial services and products (that is, financial inclusion), the ways in which families and businesses are taxed, and the nature of financial benefits and supports (such as public-income supports and private-employer benefits). Taken together, these journeys account for many of the sources and much of the distribution of capital that other development processes use to catalyze investment. Equitable growth requires a focus on the key outcomes of participation rates across financial products and services, the financial return on these products, and the average balances of accounts between groups.

The following are examples of current inclusive growth opportunities in the development of financial and transfers systems:

— **Channels for participation in the financial system.** According to a 2017 study conducted by the Federal Deposit Insurance Corporation (FDIC), nearly half of Black households are unbanked or underbanked (17 percent and 30 percent, respectively), revealing a tremendous growth opportunity. Expanding access to credit and banking and the ability to build wealth can increase overall investment and consumption in the economy, creating a potential multiplier effect. Indeed, by providing Black customers with access to financial products at the same rates as white customers (an equal-access, unequal-wealth scenario), financial institutions could realize approximately $2 billion in annual incremental revenue.49

— **Access to capital.** The average starting capital for Black-owned businesses is $35,000 compared with $107,000 for white-owned businesses.50 From the beginning, then, Black-owned businesses have a smaller margin for error. We have previously estimated that more equitable access to business ecosystems for Black business owners could add $290 billion in business equity.51 McKinsey analysis shows that if Black-owned companies were to attain the same average revenue in their industries as white-owned companies, their revenue gains would be about $200 billion.52 This estimate does not account for the multiplier effects of having higher revenue or the potential increase in the number of Black-owned businesses.
Community development and governance

Community development and governance is the process of supporting systems, rules, and norms that enable well-balanced development. Often referred to as simply "institutional development," this process encompasses factors such as how residents engage in civic life; how leaders achieve community stability and safety; and the quality, delivery, and reliability of a range of public- and social-sector goods and services (such as public education and public health). These journeys shape civic conditions and are interrelated with the other forces of development. The key outcomes on which to focus within this system include access to quality services, goods, and programs; resident satisfaction; and civic participation and engagement.

Two inclusive growth opportunities in this area are the following:

— **Service delivery for public goods.** The COVID-19 pandemic has revealed deep health inequities: Black and Hispanic Americans have significantly higher morbidity rates than white Americans, at 3.8 times and 2.5 times, respectively. Black and Hispanic workers have also been more likely to lose their jobs during the crisis, and to have less savings to protect themselves financially. Improving care infrastructure and healthcare access, as well as public safety nets, for communities of color could go a long way in improving well-being and economic outcomes for Black and Hispanic Americans.

— **Investment in housing.** The United States had a supply shortage of 2.5 million units of housing coming into the 2020 recession, creating both a challenge and a growth opportunity for the most in-need areas and for potential job locations.

Safe and affordable housing is a prime example of an opportunity for equity to drive growth. This outcome is shaped by a confluence of institutions (for example, local planning departments, developers, and lenders) that determine the location, method of development, and type of housing supply that reaches the market. Equitable increases in housing supply could not only accelerate the real-estate sector but also improve geographic connectivity of workers to job centers (for example, increasing the proximate supply of workers or reducing commute times and subsequent productivity loss) and unlock consumption from the 48 percent of renter households that are cost burdened. Low-income Americans and Black and Latino households are disproportionately affected by high housing costs: 81 percent of households earning less than $25,000 per year were rent burdened, along with more than 50 percent of Black and Latino renter households. Research shows that rent-burdened households cut back on spending on key needs, which stymies economic growth and limits long-term economic potential—from food and medical care to education and transportation, among other needs. Furthermore, some estimates suggest that unlocking housing supply could generate more than $2.3 trillion for the US economy.
Bridging the divide: How might leaders better work together to achieve inclusive growth?

The way the United States has historically approached developing and growing the economy has not worked, particularly for those most in need—as evidenced by the growing divide. Truly achieving inclusive growth will require that leaders more intentionally embed equity into the development process. Transformational change powerful enough to close these historically intractable socioeconomic disparities demands strong shifts in resources and capabilities, stakeholder interests and organizational incentives, and trust across social networks. So how should leaders go about achieving this?

Transformational change powerful enough to close these dynamics and close historically intractable disparities must be brought to bear to move the needle. In working closely with state and local governments, private and civic leaders, and communities across the country, we’ve identified a three-step approach that brings together technical expertise, adaptive approaches and mindsets, and community engagement to help practitioners overcome these challenges to foster a platform for transformational change that can help create a more inclusive economy (Exhibit 5).

Exhibit 5

Three actions, informed by three underlying principles, can help leaders successfully pursue inclusive growth.

<table>
<thead>
<tr>
<th>What to do</th>
<th>How to make it happen</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Diagnose the current state and develop a bold vision for change</strong></td>
<td>Inclusive growth is about embedding equity into the development process, which demands strong shifts in resources and capabilities, stakeholder and organizational incentives, and trust across social networks.</td>
</tr>
<tr>
<td>- Commit to an inclusive development process</td>
<td>- Adaptive approaches and mindsets</td>
</tr>
<tr>
<td>- Understand the starting point and the opportunity</td>
<td>- Technical expertise</td>
</tr>
<tr>
<td>- Align on the vision</td>
<td>- Community engagement</td>
</tr>
<tr>
<td><strong>Design comprehensive community- and human-centered interventions</strong></td>
<td>- Test and scale interventions</td>
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<td>- Identify barriers to and opportunities for impact</td>
<td>- Communicate progress and refine interventions</td>
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<td>- Design targeted interventions</td>
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<td><strong>Take coordinated action to ensure long-term accountability and momentum</strong></td>
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<tr>
<td>- Communicate progress and refine interventions</td>
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This can be best achieved through a platform for transformational change that is created by bringing together three components in execution.
1. Diagnose the current state and develop a bold vision for change

The first phase in achieving a more inclusive economy is to analyze current conditions, deeply engage communities to understand the current and historical realities they face, and identify the various stakeholders and their respective capabilities that will be critical for an equitable development process. Indeed, it is critical to take an approach that is fully rooted in the human perspective.

To help leaders analyze current conditions, McKinsey has developed an inclusive-economy framework and dashboards—backed by state and local data—that include 29 measures of economic growth, inclusion, and financial, human, and economic drivers. From here, leaders can develop a plan with clear priorities—such as what issues to address and neighborhoods and population segments to target—that can empower a community-driven strategy. Three priorities can help make this effort a success.

Commit to an inclusive development process

To be most successful, leaders should consider beginning this phase with a commitment to an inclusive development process. Too often, economic-development planning happens to communities rather than with communities. To achieve an economy with benefits that are shared across, for example, race, class, gender, and geography, leaders must directly engage diverse voices and give decision-making power to the communities they seek to empower.

An example from Fresno, located in California’s Central Valley, demonstrates how this commitment can work. The region’s DRIVE (Developing the Region’s Inclusive and Vibrant Economy) Initiative, sponsored by the Central Valley Community Foundation, set out to develop a ten-year community investment plan. The DRIVE Initiative intended to take a radically different approach to economic development planning: to involve as

“Truly achieving inclusive growth will require that leaders more intentionally embed equity into the development process.”
many members of the community as possible, to bring voices to the table that did not agree, and
to build capacity in the planning process—all with the hope that inclusion in the process would support
better outcomes.

Through its representative 40-member executive committee, leaders solicited input from a 300-person
steering committee representing more than 150 organizations in the greater Fresno region, including
businesses, faith-based organizations, nonprofits, and government agencies. Fresnans could get involved in
the planning process by participating in one of more than ten focus groups, engaging in one of many half-
day economic-development planning sessions, or directly writing investment plans across each of DRIVE’s
18 initiatives. Moreover, recognizing the entrenched racial inequalities in the region, DRIVE’s coalition
also developed a specific racial-equity plan to ensure racial equity was deeply embedded in and specifically
addressed across DRIVE’s investment portfolio. The public-, private-, and social-sector leaders who
developed the investment plan reflected the diversity of the region, and the process gave voice and power
to communities and residents who were reflective of the region.

Understand the starting point and the opportunity
Leaders must also understand the starting point and size the potential opportunity of addressing key
outcomes—considering both overall economic performance and outcomes across the four development
processes. Robust fact gathering that highlights not just current-day realities but also the rich historical
context of communities can help stakeholders fully appreciate the depth and complexities of the
challenges they face.

For example, the Business Roundtable, a consortium of CEOs from some of the country’s largest companies,
has a principal mission to promote public policy that creates a thriving US economy and expands
opportunities for all Americans. The Business Roundtable’s members annually employ more than 15 million
people and make more than $8 billion in charitable contributions. In the wake of the killing of George Floyd
and the social unrest that followed in the summer of 2020, Fortune 1000 companies committed more than
$66 billion toward improving racial equality in the United States between May 25 and October 31, 2020. Out of the top 15 corporate committers, ten were members of the Business Roundtable.

When approaching its racial-justice commitments, the Business Roundtable began by sizing the potential
opportunity. In the case of its Special Committee for Racial Equity and Justice, the consortium sorted
the key enablers for promoting well-being and prosperity for marginalized communities into six categories:
health, education, finance, employment, housing, and the justice system. They then assessed the existing
gaps in outcomes between Black and Hispanic households and white households across these six dimensions.
Stakeholders within the roundtable made individual commitments to address various outcomes. For
example, JPMorgan Chase committed $26 billion to improving affordable housing and homeownership for
Black and Hispanic households, which went toward 40,000 new home-purchase loans and 20,000 new
refinanced loans, as well as 100,000 affordable rental units.

Align on the vision
Finally, aligning on a bold, measurable aspiration that is anchored in facts and the assets of the community is
critical to achieving success. Aligning public-, private-, and social-sector leaders and communities on
a shared vision for the future provides a North Star by which to navigate measurable goals, interventions,
and investments.
Consider Detroit, Michigan. The city faced a mass exodus, and the inequalities that manifested were palpable. Unemployment for Black Detroiters was 14.6 percent in 2018, compared with 7.8 percent for white Detroiters. As the city attempts to stop the bleeding and rebuild, nonprofit organizations are helping to ensure that the rebuilding and growth process takes place inclusively. Detroit Future City (DFC), a think tank and policy advocate founded on the principles of inclusion and community, developed an economic-equity vision for Detroit through collaboration with and engagement of more than 500 community stakeholders. To align on an initial vision for this plan, DFC solicited input from a wide range of stakeholders, including Detroit youth, residents, regional community leaders, and national experts. DFC focused on creating a vision of economic equity in the city that placed all of these groups at its center and that all stakeholders could rally around. The end result was a plan to create a city in which “all Detroiters are meeting their unique needs, prospering, and fully and fairly participating in all aspects of economic life within a thriving city and region.” The creation of this vision was the first step in a multifaceted effort carried out by DFC to help revitalize the city through programs still being implemented, including programs focusing on land use and sustainability, single-family housing, reuse of industrial property, and technical assistance. The ultimate success of DFC remains to be seen, but by aligning on an initial vision with all stakeholders, DFC set itself on the path to lasting impact.

2. Design comprehensive community- and human-centered interventions
The second phase involves thoughtful planning with communities and people in mind. Practitioners should seek to deeply understand the barriers economic actors face in navigating key systems, deconstruct and reimagine key journeys, and harness community resources to design the transformation infrastructure needed to support long-term growth and inclusion.

Identify barriers to and opportunities for impact
This is the first step in designing comprehensive interventions. Practitioners should consider conducting assessments to identify the root causes impeding key journeys and forces leading to inequality. Understanding these forces will allow practitioners to assess the trade-offs of different interventions that harness community assets.

The Pittsburgh City Accelerator highlights how this works in practice. Like similar cities—including Detroit, Michigan, and St. Louis, Missouri—Pittsburgh, Pennsylvania, suffered greatly in the second half of the 20th century as the city’s manufacturing base was eroded and economic flight began to take hold. The city has seen a resurgence in the past decade as companies such as Ford’s Argo AI, Google, and Uber have attracted younger residents into the heart of the city. But leaders understood that inclusive growth was not a given.

To address this, in 2020, the City of Pittsburgh received a grant from the Living Cities Accelerator, a collective of some of the largest foundations and financial institutions in the world that are jointly committed to closing the racial income and wealth gaps in American cities. The goal in Pittsburgh was to help make the procurement and contracting processes more accessible so that more minority-owned small businesses could do business with the city. City leaders identified barriers for minority-owned businesses by speaking
directly with small-business owners and understanding what impediments they faced in gaining city contracts. Pittsburgh leaders then looked at the city’s internal government processes and identified two actions that could immediately support local businesses in better accessing government contracts: publicly displaying the city’s forecast for future solicitations and shortening the time between when a contract is awarded and when it is executed. Understanding the experience of local small-business owners helped Pittsburgh leaders identify practical challenges and pilot tangible solutions.

Design targeted interventions
Once key barriers and opportunities have been identified, players should envision solutions. Designing targeted interventions that address root problems and barriers faced by economic participants can help leaders take direct action and begin to generate more equitable outcomes (see sidebar “An inclusive home-buying and homeownership journey”). Barriers occur across four areas: economic and financial, market, political and sociocultural, and institutional and structural (Exhibit 6).

Exhibit 6

Communities of color experience unique barriers across economic systems.

Four types of barriers surface at multiple stages of key economic journeys such as buying a home

<table>
<thead>
<tr>
<th>Economic</th>
<th>Market</th>
<th>Sociocultural</th>
<th>Institutional</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listing</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Seller lists property with real estate agent</td>
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</table>

1. Listing

2. Budget
Buyer assesses personal and financial readiness and creates a budget
The racial wealth gap means certain households have less starting capital, potentially limiting housing options and location decisions

3. Mortgage preapproval
Buyers may get preapproval on mortgages from one or more lenders
Majority-minority neighborhoods have lower densities of traditional lenders and financial institutions to access mortgages

4. Tour homes
Realtors coordinate home tours
Black and Hispanic buyers are more likely to be steered to majority-minority neighborhoods and shown fewer listings on average

5. Mortgage application
Buyers submit formal application for mortgage to lenders
Black and Hispanic Americans are often offered higher mortgage interest rates even after controlling for similar credit scores

6. Home appraisal
Lender coordinates the appraisal visit to ensure the home is appropriately priced
Homes in majority-Black neighborhoods are more likely to be under-appraised due to impact of historical segregation and redlining

7. Homeowner’s insurance
Buyers evaluate providers and extent of coverage when exploring homeowner’s insurance options
Majority-minority neighborhoods have lower penetration of insurance providers and products

8. Closing/escrow
Coordinate documentation (mortgage, deed, etc), coordinate payments
Black and Hispanic households may find it more difficult to afford down payment and related closing costs due to wealth inequality

Steps in journey are typically not linear as depicted. Different steps can run in parallel, steps can be skipped, or steps might occur in a different order.
There is a clear homeownership gap in the United States among demographic groups. Compared with white Americans, Black Americans have 30 percent lower homeownership rates, Hispanic Americans have 26 percent lower rates, and Asian Americans have 16 percent lower rates. Assessing the home-buying journey and analyzing the end-to-end process through a consumer lens highlight the types of barriers that residents—particularly Black and Latino residents—face in achieving homeownership. These barriers create a more challenging path to homeownership for people of color, as shown in Exhibit 6 (examples in italics below). Understanding and removing these barriers is critical to closing the homeownership gap. While the barriers across the homeownership journey are interconnected, they often require distinct, individual solutions. Because of this, various public-, private-, and social-sector stakeholders will need to work individually to address distinct barriers within their purview, while simultaneously working together to address interconnected barriers across the journey.

Whereas traditional interventions address a single barrier at a time, true change will require coordinated action to comprehensively address key bottlenecks.

Economic and financial barriers
A major barrier to homeownership is a lack of resources. Economic and financial barriers relate to disempowerment and low starting levels of capital—for communities, families, and individuals. For example, inheritance and generational assets can contribute to a family’s ability to meet down-payment requirements, closing costs, and fees associated with home buying. And white households are more than three times as likely to receive an inheritance as Black households and more than five times as likely as Hispanic households.60

In addition, Black and Hispanic Americans are often offered higher mortgage interest rates, even after controlling for similar credit scores.61 Access to affordable financing, financial support for closing costs and associated fees, and mechanisms to preserve homeownership over time would be helpful interventions to address these challenges.

Addressing this hurdle will likely require government and private-sector action. For example, establishing baby-bond programs that provide wealth to low-income Americans or redesigning first-time homebuyer programs and supports could enable potential home purchases.

Market barriers
Even when down payments or other economic factors are addressed, market barriers can make it harder to become a homeowner. Market barriers result from unaddressed needs, often related to challenges of access. They make it such that communities of color lack access to quality products, services, and experiences that meet their needs, meaning that current innovations continue to reinforce discrimination. For example, digital real-estate marketing uses race and gender to selectively target and exclude certain populations.62 While fintech solutions have been used to decrease discriminatory lending, many algorithms still discriminate, and current regulations do not address these issues.63

Improving financial inclusion could be a key lever in overcoming market barriers for Black Americans. Black Americans are more likely to be credit invisible,
resulting in increased hurdles to gaining financing to purchase homes. Majority-minority neighborhoods also have lower penetration of insurance providers and products. The development of new products from both the government and the private sector can help in addressing this barrier. For example, alternative credit-scoring systems that seek to take a more holistic view when assessing creditworthiness, affordable lending products for small-dollar mortgages, and increased federal loan insurance through the Federal Housing Administration’s insured-loans program could help bolster capital reserves for residents previously shut out.

Political and sociocultural barriers
Political and sociocultural barriers encompass the biased and exclusionary ways groups are blocked from gaining social capital, seeing their cultural practices understood and reflected, or having their voices heard. For example, Black and Hispanic buyers are more likely to be steered to majority-minority neighborhoods and shown fewer listings on average. Rooting out these biases will likely be a key step in addressing disparate homeownership outcomes. To do so, financial institutions could conduct customer-sentiment analyses to better understand pain points for Black and Latino customers and work to address the barriers these customers face in interacting with financial institutions. Lenders can also conduct a similar sentiment analysis for their employees tasked with deciding who receives loans, illuminating both conscious and unconscious biases that may influence loan decisions. To help rectify these biases, firms can launch both internal and external communication campaigns to dispel the myth of poor credit in Black communities and any other biases unearthed during the sentiment analyses.

Institutional and structural barriers
Institutional and structural barriers reflect legacies of historical forces (such as residential segregation) and the current biases embedded in systems of rulemaking, monitoring, and enforcement. Even Black residents who can avoid all the above barriers might still face the legacy of overt institutional and structural barriers in housing. While outright exclusionary lending practices are less prevalent today, other forms of discrimination persist; often, racial minorities, LGBTQ+ individuals, and people with disabilities receive information about fewer units, have restricted housing options, and have options in fewer communities. For example, Black Americans are far more likely than white Americans to be denied conventional mortgages. According to an analysis of data from the Home Mortgage Disclosure Act, lenders deny mortgages for Black applicants at a rate 80 percent higher than that of white applicants. Similarly, early studies indicate same-sex applicants are 73 percent more likely to be denied mortgages, even when accounting for financial backgrounds. Homes in majority-Black neighborhoods are also more likely to be underappraised due to the impact of historical segregation and redlining.

In light of decades of exclusionary housing policies, disinvestment, and discrimination, structural solutions to remedy homeownership might include a two-pronged approach. This approach could focus on the detection and enforcement of discriminatory practices—for example, through government agencies such as the Department of Justice and the Department of Housing and Urban Development—as well as an inside-out commitment to diversity and inclusion initiatives, such as racial-equity training from within lending and real-estate firms. Addressing these macro barriers will require coordination among government agencies, state and local governments, private financial institutions and credit-rating agencies, brokers and industry groups, housing nonprofits, and local community organizations. Stakeholders must work as individual drivers of change and coordinate action with other stakeholders to address barriers to equitable homeownership across the entire home-buying journey.

And while addressing these macro barriers to homeownership is critical, doing so is not the only way to improve socioeconomic performance. Increasing affordable rental housing in regions with high job access can also produce a positive impact on socioeconomic equality without directly leading to homeownership. While homeownership has been a staple of wealth building in the United States for generations, asset building can take place in many different ways.
3. Take coordinated action to ensure long-term accountability and momentum

In the third phase, leaders can launch a multisector coalition and establish inclusive transformation infrastructure to implement interventions, foster long-term accountability, and reinforce commitments to equity.

Test and scale interventions

Sustaining progress at the firm, sector, and societal levels and embedding sufficient accountability mechanisms are key to achieving inclusive economic outcomes over time. Public-, private-, and social-sector leaders can institute transformation infrastructure based on the implementation needs identified for interventions. Transformation infrastructure could meaningfully engage internal and external stakeholders and could include monitoring and evaluation systems that collect feedback; ready-to-launch, designed pilot initiatives to help establish proofs of concept; and mechanisms to pivot action based on feedback.

Communicate progress and refine interventions

Through testing and creating proof points, leaders will be able to track progress and integrate feedback. It is important for leaders to continually communicate this progress with communities and refine interventions based on the feedback collected.

The Atlanta BeltLine is an example of how this could work. Atlanta BeltLine Inc. was formed in 2006 by the Atlanta Development Authority to oversee planning and execution of a vision to achieve equitable, inclusive, and sustainable city life. Born from grassroots community efforts to address economic-development challenges related to transit and housing, the organization has kept the community engaged and updated on its progress. To date, Atlanta BeltLine has held 355 public meetings with nearly 14,000 total attendees.69 Quarterly briefings are just one of the ways the organization maintains a transparent process; it complements these meetings with ongoing opportunities for community members to share input, including through study groups, citywide conversations, pop-ups, and resident roundtables. It is worth noting that communicating progress and refining interventions through regular interaction with the community is not
Economic growth is threatened by inequality, and poor economic performance is caused by gaps in economic flows that result from unequal participation and productivity in the economy. Indeed, inclusivity and economic growth must happen together. To support this, leaders must make investments that embed equity into the development process. Leaders can measure the success of their efforts at three different levels to ensure they’re progressing toward their goals: At the highest level, they can track macro outcomes, such as poverty rate, unemployment rate, and availability of affordable housing. At the indicator level, leaders can track key performance indicators such as employment of women in manufacturing and diversity of the C-suite across financial-services firms. Finally, at the initiative targets level, leaders can track indicators such as the number of women hired, retention of Black employees, and the amount of grant funding disbursed.

Each sector will also have a unique role to play. For example, the public sector can address structural challenges through structural transformation, such as fiscal and monetary policy; the private sector can proliferate inclusive practices in the market; and the civic sector can create integrative solutions based on its understanding of local challenges. And by working together, public-, private-, and social-sector leaders have the opportunity to help various demographic groups overcome the barriers that have kept them from fully participating in and contributing to an economy that benefits everyone. To have the greatest impact, they should begin this work today.

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Appendix

Empirical connections between growth and equity
Empirical evidence from within the United States and across the globe indicates that economic growth and inclusion are best achieved in parallel. Specifically, there are many reasons to believe that increasing equality of opportunity and reducing economic inequality can help increase productivity and economic prosperity in the long term. The empirical data point to several facts.
Growth is a requirement for reducing poverty and improving living standards

It is difficult to advance human development goals, such as eliminating poverty or broadly raising living standards for society, without increasing the size of the economy and connecting people to opportunities. This is highlighted by a recent World Bank report showing the strong positive correlation (a correlation coefficient of +0.856) between growth in a country’s mean income and the income share of the bottom 40 percent of its population.71

Growth does not always lead to inclusion and can, in fact, lead to economic inequality

Economic growth in and of itself does not lead to broad increases in income. We can see this in data on the most recent economic expansions in the United States:

— **Income inequality.** In the economic expansion from 2010 to 2015, the top 10 percent of income earners received about 50 percent of income growth, with the bottom 50 percent of income earners receiving less than 15 percent.72 Going back further, the bottom 50 percent of American workers have experienced virtually no growth in income before taxes and transfers since 1980, while the earnings of all adult earners over this same period grew by 61 percent.73

— **Wealth inequality.** This income inequality has naturally translated into large disparities in wealth. From 1983 to 2010, the bottom 50 percent of Americans experienced a net decrease in wealth. During the same period, the top 1 percent of Americans experienced an increase in wealth of up to 40 percent.74 Furthermore, as of 2019, the top 1 percent of Americans hold more than 30 percent of total wealth in the United States, and the bottom 50 percent hold less than 2 percent.75
Economic inequality is driven by three imbalances in the returns to workers, investors and entrepreneurs, and consumers for economic participation

The main way people participate in the economy is through work. And despite decades of growth in the United States, researchers have observed a widening disconnect between productivity and a typical worker’s pay, which is creating economic inequality. The determinants of this gap are threefold: the shift in the overall share of income received by workers versus owners of capital (that is, investors and entrepreneurs); compensation inequality among workers (including nonwage benefits and compensation); and the “terms of trade” for workers—or the gap in inflation between the goods workers consume (such as education, healthcare, and housing) and what they produce. Since 1980, the biggest factor contributing to the productivity–wage gap has been compensation inequality (50 percent), followed by inflation (30 percent) and shift in capital share (about 15 percent). However, since 2000, a strong shift in capital’s share of total income has explained 45 percent of the gap, followed by wage compensation (35 percent) and then terms of trade.\(^{26}\)

Inequality begets further inequality through lower living standards and less social mobility

Left unchecked, high levels of inequality can become cemented because of low intergenerational social mobility and living standards that do not rise in line with economic growth. Research has shown the depth of this relationship down to the neighborhood level, driven by the inability of parents and whole communities to make investments in their children and in their physical and social environments. In other words, economic
inequality (through higher economic and social segregation, lower-quality public services, higher family instability, and lower community cohesion) restricts the opportunities available to the children of residents in poorer neighborhoods or with marginalized identities (exhibit), limiting their ability to benefit from the growth opportunities occurring around them. 

Exhibit

**Economic growth without inclusion leads to economic and social inequality, which affects living standards and lowers mobility.**

There has been a growing disconnect between productivity and average worker compensation

Cumulative percent change since 1948

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Productivity</td>
<td>96.7%</td>
</tr>
<tr>
<td>Hourly compensation</td>
<td>91.3%</td>
</tr>
</tbody>
</table>

This example of growth without inclusion has affected intergenerational mobility

Inequality also threatens long-term growth and prosperity

Overall, research continues to show a negative relationship between growth and inequality for advanced and developing economies alike through both supply and demand channels. For example, in terms of supply, children living in poor households have less exposure to innovation in childhood, creating “lost Einsteins” and lowering productivity through innovation. On the demand side, there is evidence that, in the long term, inequality shrinks aggregate demand, preventing local and national economies from benefiting from tight labor markets and full employment—and subsequent demand externalities. As two International Monetary Fund (IMF) economists wrote in a report on the topic, “One reasonably firm conclusion is that it would be a big mistake to separate analyses of growth and income distribution. To borrow a marine analogy: a rising tide lifts all boats, and our analysis indicates that helping raise the smallest boats may help keep the tide rising for all craft, big and small.”

Inclusive growth is achievable—and it is critical to the reduction of economic inequality and the support of long-term growth

The task at hand for leaders is to focus on investments that support inclusive growth. Fortunately, inclusive growth is achievable: recent OECD research shows that between 1980 and 2013, inclusive growth was achieved in more than 260 cases across 78 countries. The duration of these inclusive growth periods varied, but the average duration was more than 2.5 years. Critical to sustaining inclusive growth is managing the impact of inequality through short- and long-term investments in economic mobility. For example, recent research has shown that countries demonstrating better equality of opportunity (as measured by intergenerational mobility) were able to mute the impact of inequality on growth.

Inclusive growth is about advancing human well-being

Ultimately, inclusive growth is about achieving sustainable development to support human well-being and happiness. There are many links between economic development and human development. Indeed, recent research shows quadratic links between performance against the UN Sustainable Development Goals and human well-being. Inclusive growth blurs the line between human and economic development, reinforcing them mutually over time.
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3  We define prosperity as poverty alleviation, improved living standards, having a financial safety net, and being able to invest in future generations.
5  “This is now the longest US economic expansion in history,” July 2, 2019.
6  The Gini index is a measure of the distribution of income across a population. A higher Gini index indicates greater inequality, with high-income individuals receiving much larger percentages of the total income of the population.
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16  “803,000 Americans filed for unemployment last week,” December 23, 2020.
18  Economic development expert survey, n = 53, November 2020. One respondent (2%) stated that inclusive growth should primarily benefit those at the top.
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23  Economic development expert survey, n = 53, November 2020. One respondent (2%) stated that inclusive growth should primarily benefit those at the top.


27 Anna North, “The Great Recession was called a ‘mancession.’ This one could be devastating for women,” Vox, June 10, 2020, vox.com.


31 Brian Thiede et al., “Six charts that illustrate the divide between rural and urban America,” The Conversation, March 16, 2017, theconversation.com.

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Increases in GDP per capita without an associated deterioration in the distribution of household disposable income.


