

Chapter 10

The Economic Consequences of DEI

Gary Becker's (1957) seminal *The Economics of Discrimination* established the theory that labor market discrimination reduces aggregate output by distorting the allocation of talent. When employer prejudice prevents optimal worker-job matching, the economy fails to fully realize its potential by placing people in jobs they are not well suited to, resulting in productivity losses. Researchers have found evidence that this theory holds up in practice, with one recent study finding that the removal of discriminatory barriers after the passage of the Civil Rights Act of 1964 improved worker-job matching and generated substantial productivity gains as talented black workers were able to contribute their talents to their greatest economic use.

Beginning in the mid-2010s, American corporations substantially expanded their diversity, equity, and inclusion (DEI) initiatives in hiring and promotion. Whereas the Civil Rights Act prohibited hiring based on race, DEI actively encouraged it. Influenced by consulting analyses—particularly McKinsey & Company's reports linking managerial diversity to productivity and financial success—major employers adopted targets for increasing minority shares in management. Between 2016 and 2023, the share of minorities in management positions grew at more than four times the rate observed in the prior decade, representing a marked departure from historical trends.

This acceleration in DEI hiring and promotion raises an important question: Did DEI's implementation reflect the removal of discriminatory barriers—allowing previously excluded talent to realize positions matching their abilities—or did it represent a new form of discrimination in labor market matching? The elimination of bias against qualified minorities should enhance economic efficiency by

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improving worker-job matches, while identity-based promotion that prioritizes race over productivity-relevant qualifications would introduce the same distortions Becker identified, ultimately reducing aggregate output.

This chapter examines this question by measuring the relationship between DEI-based hiring and promotion practices on one hand and sectoral productivity on the other. Directly measuring the extent of DEI practices by a specific industry in a specific State is elusive, so the analysis here uses a proxy: the unexplained minority manager share after controlling for State, industry, and year fixed effects. What this means is that if a certain industry in a certain State undergoes a faster increase in the minority manager share than implied by aggregate trends, this suggests the practice of DEI. The expectation is that the DEI proxy had no effect before the mid-2010s because the extent of DEI practices was quite limited before that time.

Indeed, statistical analysis reveals that throughout the 2000s and early 2010s, there was no relationship between this proxy and productivity, suggesting statistically low levels of racial discrimination in promotion and hiring. After 2016, however, DEI practices are associated with significantly lower productivity. By 2023, industries that heavily pursued DEI were approximately 2.7 percent less productive than those that did not. The fact that this negative relationship only appears after 2016, when DEI pressures intensified, suggests that this finding has nothing to do with changes in the demographic composition of managers directly but rather with the DEI-based promotion practices that prioritize race over qualifications and contribution. It does not speak to the capabilities of any demographic group; an opposing discrimination against minorities would likely have caused a similar productivity decline.

These results imply that DEI practices lead to inefficient management, which raises the cost of doing business. These costs get passed down to consumers in the form of higher prices or worse quality. They also have an impact on the companies themselves, which end up hiring fewer people and paying their workers less. In the aggregate, the cost of mismanagement was roughly $94

billion annually by 2023, or 0.34 percent of U.S. GDP. This is an average cost of about $1,160 annually for a family with two working adults. This calculation only captures the effects of identity-based promotion into management; it does not include the costs of stigmatization, in which highly qualified minorities face perceptions of unfair gain (Coate and Loury 1993).

These findings complement the findings of Hsieh and colleagues (2019) that removing discriminatory barriers under the Civil Rights Act improved worker-job matching and generated substantial productivity gains, accounting for 20–40 percent of per capita income growth between 1960 and 2010. While this research documents gains from expanding talent pools, the analysis in this chapter identifies losses resulting from policies that effectively narrow talent pools. Both results confirm that deviations from meritocracy carry significant macroeconomic costs.

In support of equal opportunity for all Americans, the Trump Administration has undertaken substantial policy reforms to end discrimination of all kinds. Executive Orders issued in early 2025 eliminated DEI-based hiring and promotion requirements across Federal agencies, reversing harmful policies implemented by the past Administration. The Trump Administration has also discouraged similarly harmful practices in the broader labor market via regulatory and enforcement mechanisms among Federal contractors and educational institutions receiving Federal funds. Data from 2025 show a decline of DEI practices in the corporate world, marking a return to equal opportunity.

The Rise of DEI

DEI initiatives as we know them today were not widely practiced in the American private sector before a sea change began in the 2010s. Research by Rozado (2020)—and later by Rozado, Al-Gharbi, and Halberstadt (2023)—documents a substantial shift in the language used by elite media and education institutions starting in about 2013–15. Much greater social emphasis was suddenly placed on terms related to identity-based concerns (e.g., racism, sexism, and gender discrimination).

The flagship consulting company McKinsey & Company gave its imprimatur to this rising trend. McKinsey published reports in 2015 claiming that "when companies commit themselves to diverse leadership, they are more successful" (McKinsey 2015). In 2018 and 2020, McKinsey released new reports reaffirming its argument that diversity was a critical resource that could be unlocked by contracting the services of McKinsey (2018, 2020).

In 2021, the Biden Administration issued Executive Order 13985, "Advancing Racial Equity and Support for Underserved Communities through the Federal Government"; and Executive Order 14035, "Diversity, Equity, Inclusion, and Accessibility in the Federal Workforce." These orders directed Federal government agencies to take various measures to "enhance diversity, equity, inclusion, and accessibility within the agency, . . . seek opportunities to establish a position of chief diversity officer or diversity and inclusion officer, . . . ensure that all Federal employees have their respective gender identities accurately reflected and identified in the workplace . . . [and expand] employment opportunities for formerly incarcerated individuals."

The Department of the Treasury provides an example of how these orders were implemented. Treasury Secretary Janet Yellen issued a statement that "commitment to the values of diversity, equity, and inclusion is expected of every employee." Per reporting by Rufo (2024), in response to this directive, Treasury promptly established its official Equity Hub and its Advisory Committee on Racial Equality; it added a Counselor for Racial Equity to its payroll and spent millions of dollars on DEI consulting services. As a result of all this, Treasury undertook efforts to redirect billions of dollars in funding toward programs designed to benefit specific racial groups. Furthermore, it demonstrated its intensified commitment to favoring minority-owned businesses when awarding Federal contracts. These actions further entrenched DEI practices in American economic life, elevating them to a role never before seen in American government.

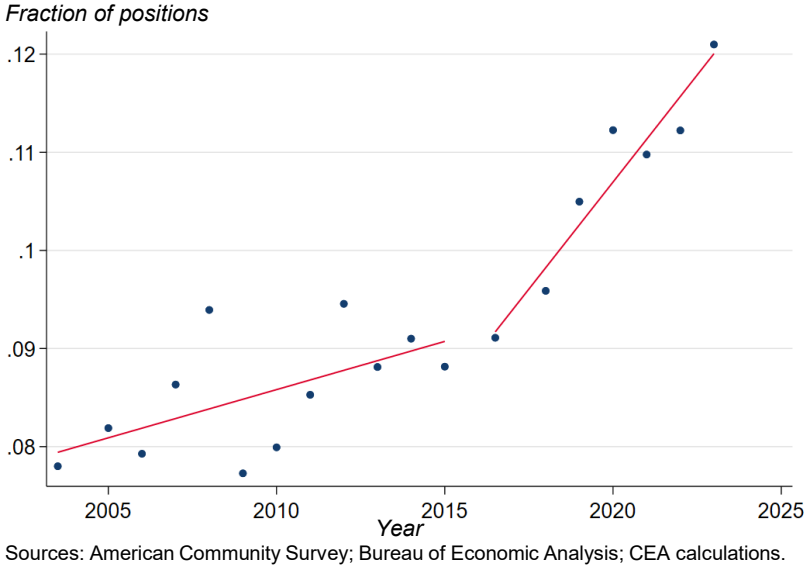
During the early 2020s, corporations ramped up DEI efforts. References to DEI became ubiquitous in American industry as firms spent billions of dollars constructing DEI programs and hiring DEI officers and consultants. As reported by Kessler (2024) and Lau and Telford (2025), virtually every major company began discussing DEI in its annual financial filings and earnings calls—places where discussions of race and group identity would have previously seemed strange and out of place. As detailed by Goldstein and others (2022), the number of jobs explicitly related to DEI *quadrupled* in only five years, from 2017 to 2022. The Chief Diversity Officer position, previously virtually unknown, became the fastest-growing C-suite executive position in the early 2020s. Business publications regularly suggested that DEI could be used to improve workplace productivity, such as in articles by Heisler (2020), S&P Global (2022), and Wenner (2025).

Research has found that the forecasted economic benefits of DEI efforts did not materialize. Research by Green and Hand (2024) illustrated that the McKinsey studies were purely correlational, making no attempt to rule out reverse causality (the idea that successful firms could afford elaborate DEI programs, rather than DEI programs making firms successful). Furthermore, the sample appeared cherry-picked, comparing only top and bottom quartiles of executive diversity while excluding the middle 50 percent of companies for no methodological reason. When Green and Hand attempted to replicate the results, they found no statistically significant relationship between demographic diversity measures and firm performance metrics—including the margin of earnings before interest and taxes, return on assets, return on equity, and total shareholder return. Research by Johnston and Wheaton (2026) goes further, finding that DEI hiring efforts had negative effects on aggregate productivity. This chapter explores these findings and their implications.

The Results of DEI: Effects on Productivity

A key focus of DEI programs is to increase the share of certain minority groups (black, Hispanic, and Native American) in management roles, sometimes entailing new positions—such as Diversity Officers—to further this goal. The share of minority managers increased rapidly after the cultural ramp-up in DEI. Data from the American Community Survey show that the share of management

Figure 10-1. The Share of Minorities in Management Positions as a Fraction of All Management Positions



Sources: American Community Survey; Bureau of Economic Analysis; CEA calculations.

positions held by minorities increased gradually by less than 1 percentage point in the decade between 2005 and 2015, and it then increased by nearly four times that amount in the eight years between 2015 and 2023—a substantial and statistically significant acceleration. This trend is shown in figure 10-1.

What are the consequences for the productivity of the firms undertaking this deliberate expansion? To test for a systematic relationship between DEI practices and industry performance, a thorough analysis is needed. Most important, because a firm's motivations are not directly observable, there needs to be a proxy for DEI practices. Absent DEI motivations, minority hiring should not meaningfully vary after controlling for industry, year, and State. Thus, the empirical specification includes industry-by-State fixed effects, industry-by-year fixed effects, and State-by-year fixed effects to capture any minority hiring for non-DEI reasons. With non-DEI-motivated hiring captured by these fixed effects, any explicit increase in the minority hiring share above and beyond the level predicted by fixed effects serves as a useful proxy for DEI practices. These features are all incorporated in a regression model of this form:

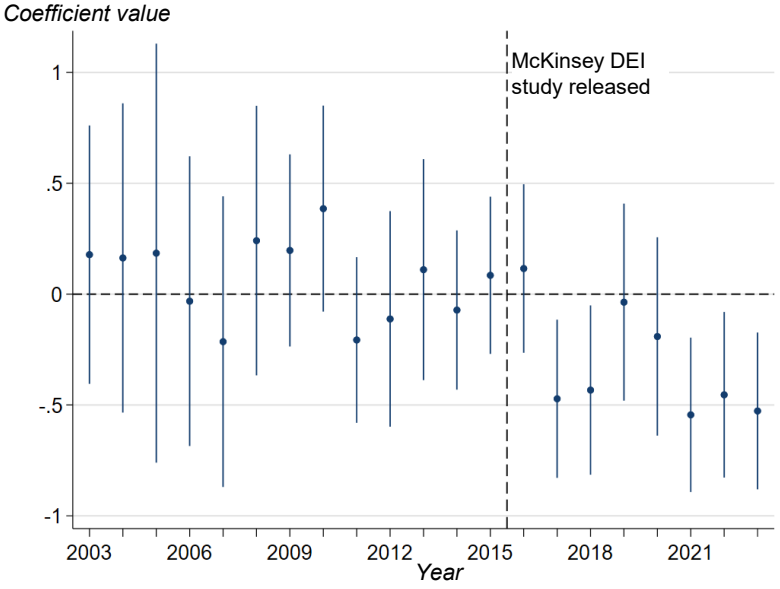
$$Y_{i,s,t} = \alpha + \beta_t UnexplainedMinorityManagerShare_{i,s,t} + Y_t UnexplainedMinorityNonmanagerShare_{i,s,t} + \rho_t UnexplainedManagerShare_{i,s,t} + W_{i,s,t} + \eta_{i,s} + \sigma_{i,t} + \kappa_{,s,t} + \epsilon_{i,s,t}$$

Here,

- $Y_{i,s,t}$ denotes productivity (i.e., log output per hour) in industry i of State s during year t,
- $UnexplainedMinorityManagerShare_{i,s,t}$ denotes the residual of the share of minority managers as a fraction of all employees in industry i of State s during year t after controlling for fixed effects (with $UnexplainedMinorityNonmanagerShare_{i,s,t}$ and $UnexplainedManagerShare_{i,s,t}$ defined analogously),
- $W_{i,s,t}$ denotes a control for compensation (i.e., log wage) in industry i of State s during year t,
- $\eta_{i,s,}$ denotes an industry-by-State fixed effect,
- $\sigma_{i,t}$ denotes an industry-by-year fixed effect,
- $\kappa_{,s,t}$ denotes a State-by-year fixed effect, and
- $\epsilon_{i,s,t}$ denotes an error term.

The β_ts represent the effect of an increase in the share of minority managers above and beyond the norm for that industry, State, and year on productivity. To reiterate, the rich set of fixed effects ensures that the results cannot be driven by the fact that certain industries in certain States simply have a higher share of minority managers for unobserved reasons that happen to be correlated with lower productivity. Nor can they be driven by an increase in the overall (minority plus nonminority) manager share of employees, since that is explicitly controlled for. Identification relies on comparing productivity and the unexplained share of minority managers across different industries within the

Figure 10-2. Noticeable Effect of DEI Practices on Productivity (Log Output per Hour)



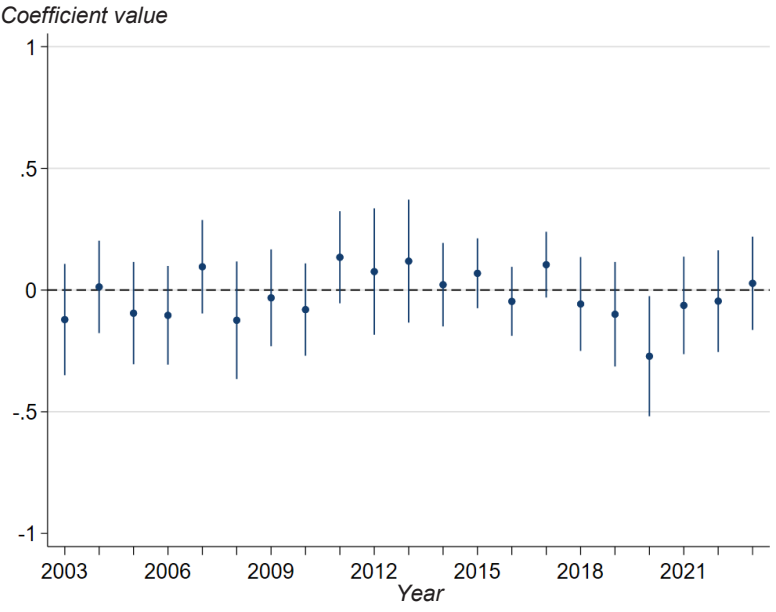
Sources: American Community Survey; Bureau of Economic Analysis; CEA calculations.
Note: ESG = environmental, social, and governance.

same State and year, different States within the same industry and year, and over time within the same State and industry.

The resulting regression coefficients (the β_ts and the γ_ts) are plotted in figures 10-2 and 10-3, along with 95 percent confidence intervals for each. As seen in figure 10-2, the effect of the unexplained minority manager share on productivity is flat and statistically no different from zero throughout the 2000s and the first half of the 2010s—there is no relationship between having more minority managers and productivity. This changes in the middle to late 2010s, after which the relationship is negative and statistically significant in most years. Having a higher unexplained share of minority managers now results in reduced productivity, notably coinciding with the timing of the rapid DEI increase in minority management. These results imply that, as of 2023, industries that pursued DEI heavily (those 1 standard deviation above the average) were about 2.7 percent less productive than those which did noy (1 standard deviation below).

Meanwhile, the effect on productivity of the unexplained share of minority nonmanagers is not significantly different from zero throughout the entirety of the period examined, as seen in figure 10-3. A natural takeaway from these two figures is that there is nothing inherently less productive about minority workers or minority managers. The issue is rapidly promoting unqualified workers in order to meet racial quotas set forth by DEI. There are clearly many qualified minority managers; the nonnegative effect of the minority manager share on

Figure 10-3. No Effect of Minority Nonmanager Share on Productivity (Log Output per Hour)



Sources: American Community Survey; Bureau of Economic Analysis; CEA calculations.

productivity before 2017 attests to this. It is worth observing that DEI actually does a disservice to these qualified minority managers, as they may experience a stigma if they are viewed as being DEI hires, a phenomenon studied by Coate and Loury (1993).

The Results of DEI: Overall Effects on GDP

These estimates imply that DEI promotion has led to inefficient management, raising the cost of doing business. These costs lead the companies practicing DEI to hire fewer people and pay their workers less. In the aggregate, this implies meaningfully reduced gross domestic product (GDP) in recent years, because a reduction in output per hour implies a reduction in aggregate output. Since 2017, the DEI proxy has rapidly grown at the same time as its measured effect on productivity has become significantly negative. It is possible to obtain an estimate of the aggregate impact on GDP in a given year resulting from this misallocation. This can be done by multiplying the coefficient value in that year by the gap between the DEI proxy in that year and what the DEI proxy would have been if it continued to grow according to the trend before 2017, when DEI efforts intensified and the coefficients became negative and statistically significant. For example, the coefficient value for 2023 is −0.527 and the cumulative increase in the DEI proxy relative to pre-DEI trend is 0.65 percentage point (0.90 minus

0.25). This implies a 0.34 percent decline in 2023 GDP relative to a no-DEI counterfactual. Alternatively stated, promotion into management on the basis of race—a key consequence of DEI initiatives—cost the U.S. economy roughly $94 billion in 2023 alone. This works out to an average cost of about $1,160 in 2023 alone for a family with two working adults. This number grew rapidly in the late 2010s and early 2020s.

These findings mirror insights from Hsieh and others (2019), who show that the reduction in labor market discrimination under the Civil Rights Act significantly enhanced productivity and GDP by improving the matching of workers to jobs best suited to their abilities. In this way, reductions in discrimination served as a boon to the U.S. economy. Unfortunately, the reimposition of discriminatory practices through DEI initiatives reversed some of these gains.

The Restoration of Equal Treatment Under the Law

From the moment President Trump entered office in January 2025, the Trump Administration began taking action to combat DEI. Executive Order 14151, issued on Inauguration Day, required all Federal departments to terminate all DEI-related activities. Executive Order 14173, issued one day later, repealed Executive Order 11246, the order that served as the grandfather of DEI programs; it was the original source of requirements that Federal contractors must meet government-set thresholds in hiring minority workers or would be denied future contracts. In August 2025, President Trump issued Executive Order 14332, banning grants by the Federal government that promote DEI. Also that month, the President issued a Presidential Memorandum targeting the use of diversity statements and other racial proxies in college admissions to help ensure that universities receiving Federal aid do not discriminate on the basis of race in pursuit of DEI. This helps shut down the pipeline for future attempts at reinstituting DEI policies.

The effects of the Trump Administration's efforts have not been limited to the realms of government and education. As documented in *Forbes* by Murray and Bohannon (2025) and on Fox News by Singman (2025), a lengthy list of American corporations has rescinded their DEI requirements. As noted in the *Washington Post* by Lau and Telford (2025); in the *New York Times* by Goldberg, Krolik, and Boyce (2025); and in *Forbes* by Murray (2025), references to DEI in corporate filings, proxy statements, and earnings calls have dropped substantially—down by 72 percent in 2025. Some companies have acknowledged that DEI practices increase litigation risk, including the risk of challenges from civil rights advocacy groups like America First Legal, leading some to reverse or revise their policies. In sum, American corporations have increasingly begun to roll back their DEI programs in response to the revival of American

meritocracy under the leadership of the Trump Administration, curtailing DEI and the economic losses that came with it.