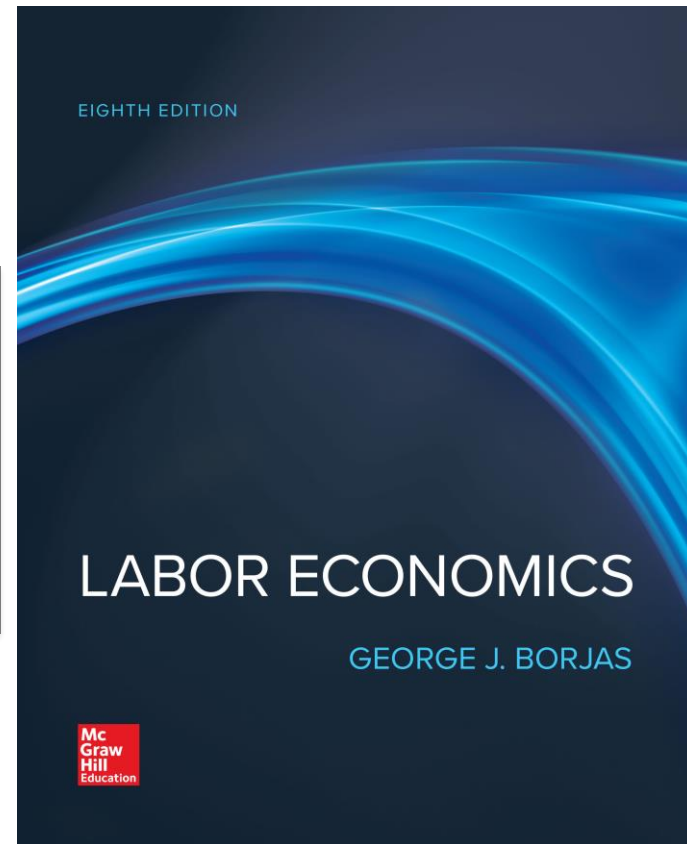


# Chapter 9

## Labor Market Discrimination



“God, what gorgeous staff I have. I just can’t understand those who have ugly people working for them. I really can’t. Just call me a pathetic aesthetic”  
-Jade Jagger  
(Mick’s Daughter)

# Introduction

Discrimination occurs when the marketplace takes into account such factors as race and sex when making economic exchanges.

# Race and Gender in the Labor Market

Men earn more than women, and whites usually earn more than nonwhites.

Differences in educational attainment between whites and nonwhites account for a portion of the wage differential.

# The Discrimination Coefficient

Taste discrimination translates the notion of racial prejudice.

- Racial prejudice causes employers to blindly perceive the costs of hiring blacks as being higher than the true cost.
- Even though it costs  $w_b$  dollars to hire one person-hour of black labor, the employer acts as if it costs  $w_b(1+d)$  dollars, where  $d$ ,  $d>0$ , is the discrimination coefficient.

# Employer Discrimination

- Implication of the Becker model

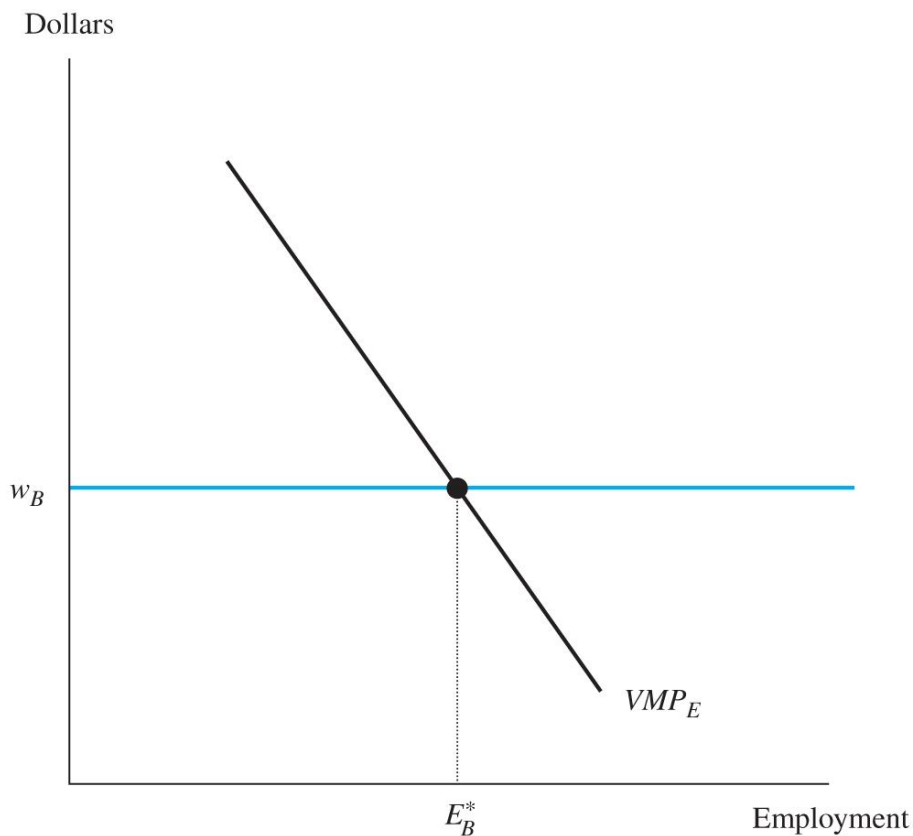
If blacks and whites are perfect substitutes, employers have a segregated work force.

- Even non-discriminating employers have a segregated work force, as they employ all black workers

Discrimination does not pay.

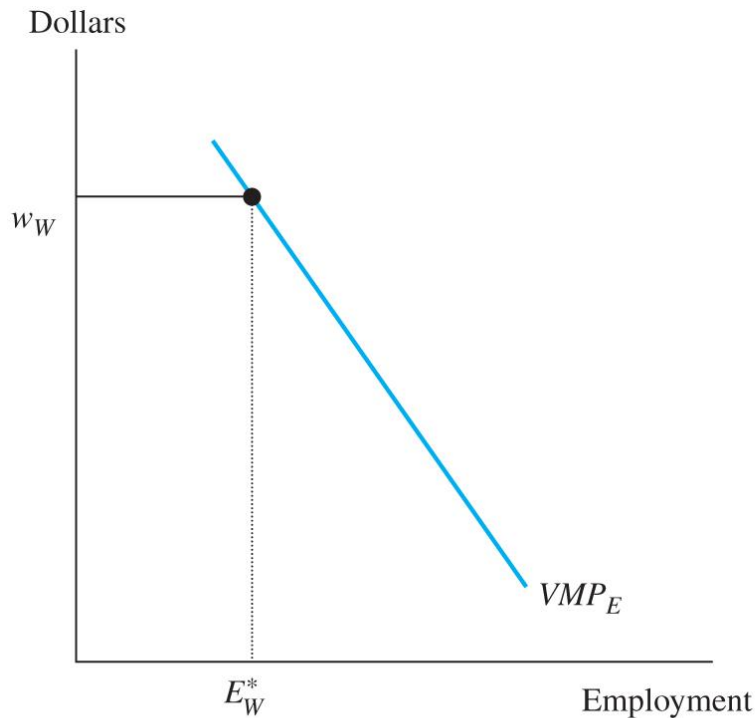
- Employers hire the wrong type of worker and/or they hire the wrong number of workers.

# The Employment Decision for a Firm That Does Not Discriminate

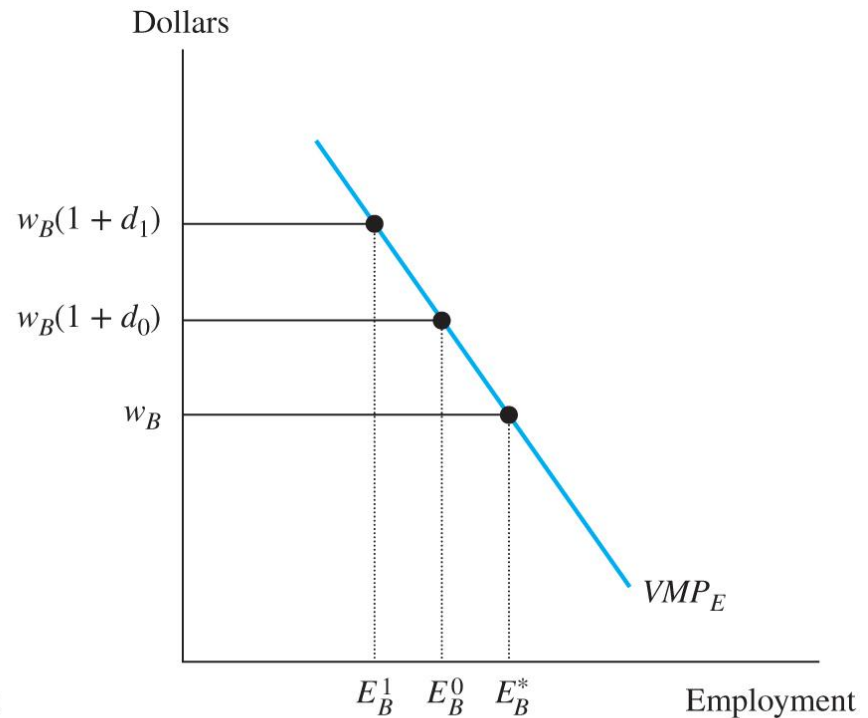


If the market-determined black wage is less than the white wage, a firm that does not discriminate will hire only blacks. It hires black workers up to the point where the black wage equals the value of marginal product of labor,  $E_B^*$ .

# The Employment Decision for a Prejudiced Firm



(a) White Firm

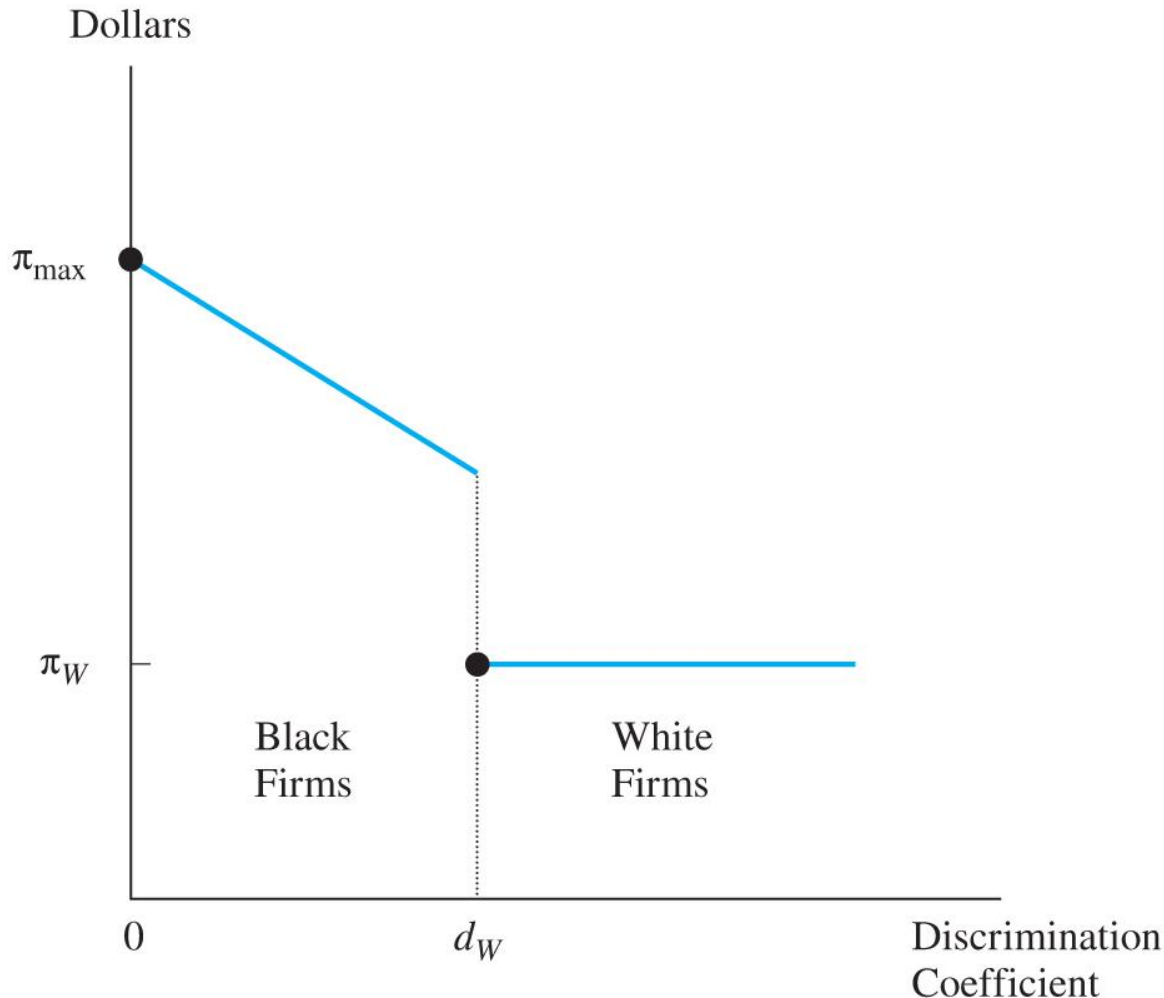


(b) Black Firm

Firms that discriminate can be either white firms (if the discrimination coefficient is very high) or black firms (if the discrimination coefficient is relatively low). A white firm hires white workers up to the point where the white wage equals the value of marginal product. A black firm hires black workers up to the point where the utility-adjusted black wage equals the value of marginal product. Firms that discriminate hire fewer workers than firms that do not discriminate.



# Profits and Discrimination



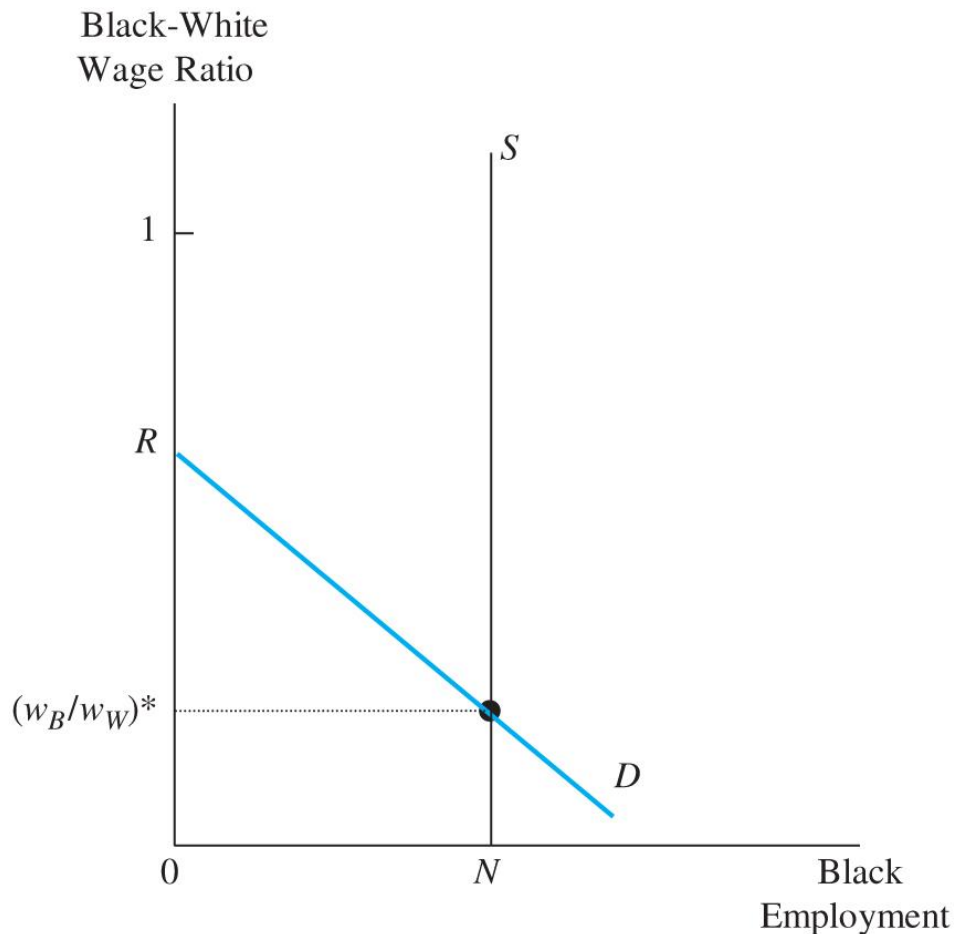
Discrimination reduces profits in potentially two ways. A discriminatory firm that hires only white workers will hire too few workers at a very high wage. Even a discriminatory firm that only hires black workers is harmed by its actions as it hires too few workers.

# The Black-White Wage Ratio in the Labor Market

Employer discrimination generates a wage gap between equally skilled black and white workers.

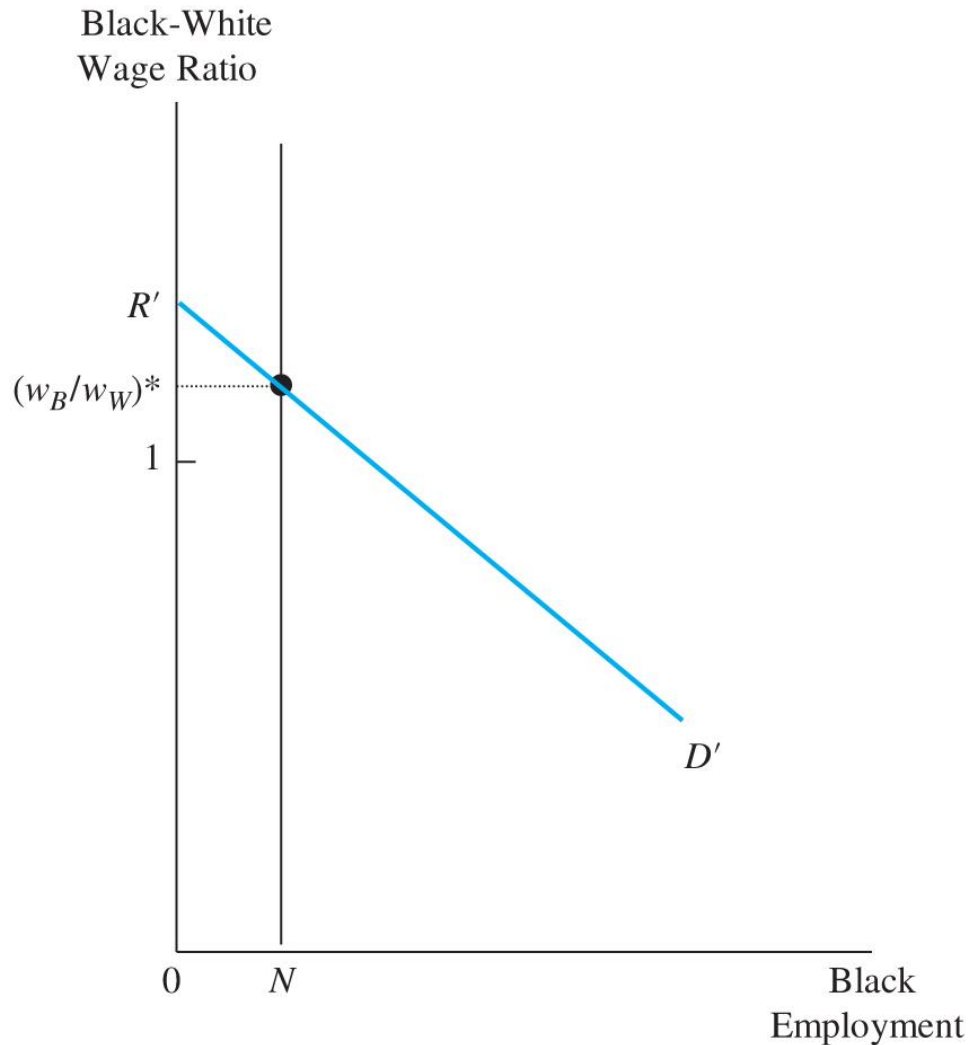
The quantity demanded for black labor increases as the black-white wage ratio falls.

# Determination of Black/White Wage Ratio in the Labor Market



If the black-white wage ratio is very high, no firm in the labor market will want to hire blacks. As the black-white wage ratio falls, more and more firms are compensated for their disutility and the demand for black workers rises. The equilibrium black-white wage ratio is given by the intersection of supply and demand, and equals  $(w_B/w_W)^*$ .

# Determination of Black/White Wage Ratio in the Labor Market



If some firms prefer to hire blacks, they would be willing to hire blacks even if the black-white wage ratio exceeds 1. If the supply of blacks is sufficiently small, it is then possible for the black-white wage ratio to exceed 1.

# Employee Discrimination

Employee discrimination does not generate a wage differential between equally skilled black and white workers.

Employee discrimination does not affect the profitability of firms.

Work places will be segregated

# Customer Discrimination

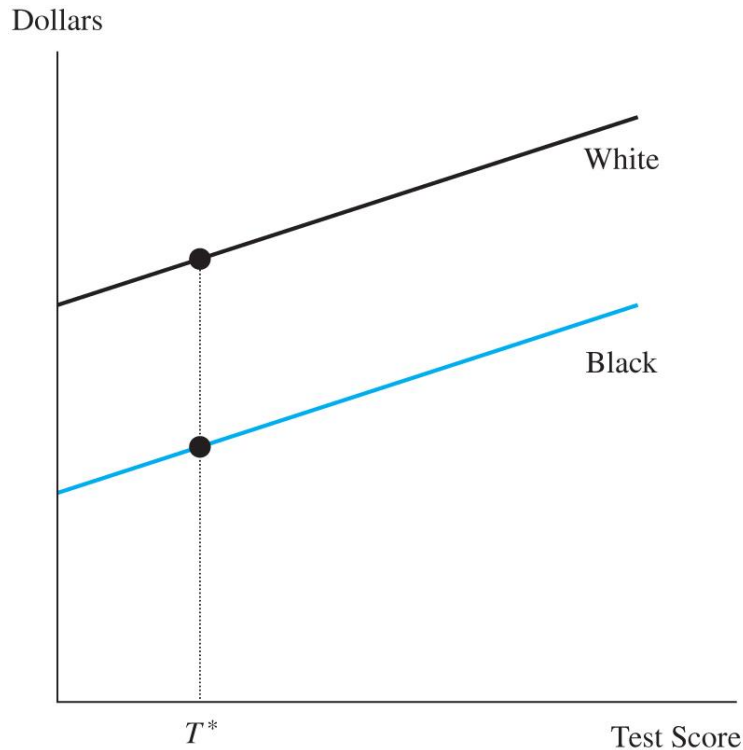
If customers discriminate, their perceived price of a good is utility-adjusted with a discrimination coefficient.

When a firm cannot hide black workers, customer discrimination can have an adverse effect on black wages.

# Statistical Discrimination

Statistical discrimination is based on treating an individual on the basis of membership in a group and knowledge of that group's history.

# The Impact of Statistical Discrimination on Wages



(a) Whites Have a Higher Average Score



(b) Test Is Better Predictor for White Workers

The worker's wage depends not only on his own test score, but also on the mean test score of workers in his racial group. (a) If black workers, on average, score lower than white workers, a white worker who gets a score of  $T^*$  earns more than a black worker with the same score. (b) If the test is a better predictor of productivity for white workers, high-scoring whites earn more than high-scoring blacks, and low-scoring whites earn less than low-scoring blacks.



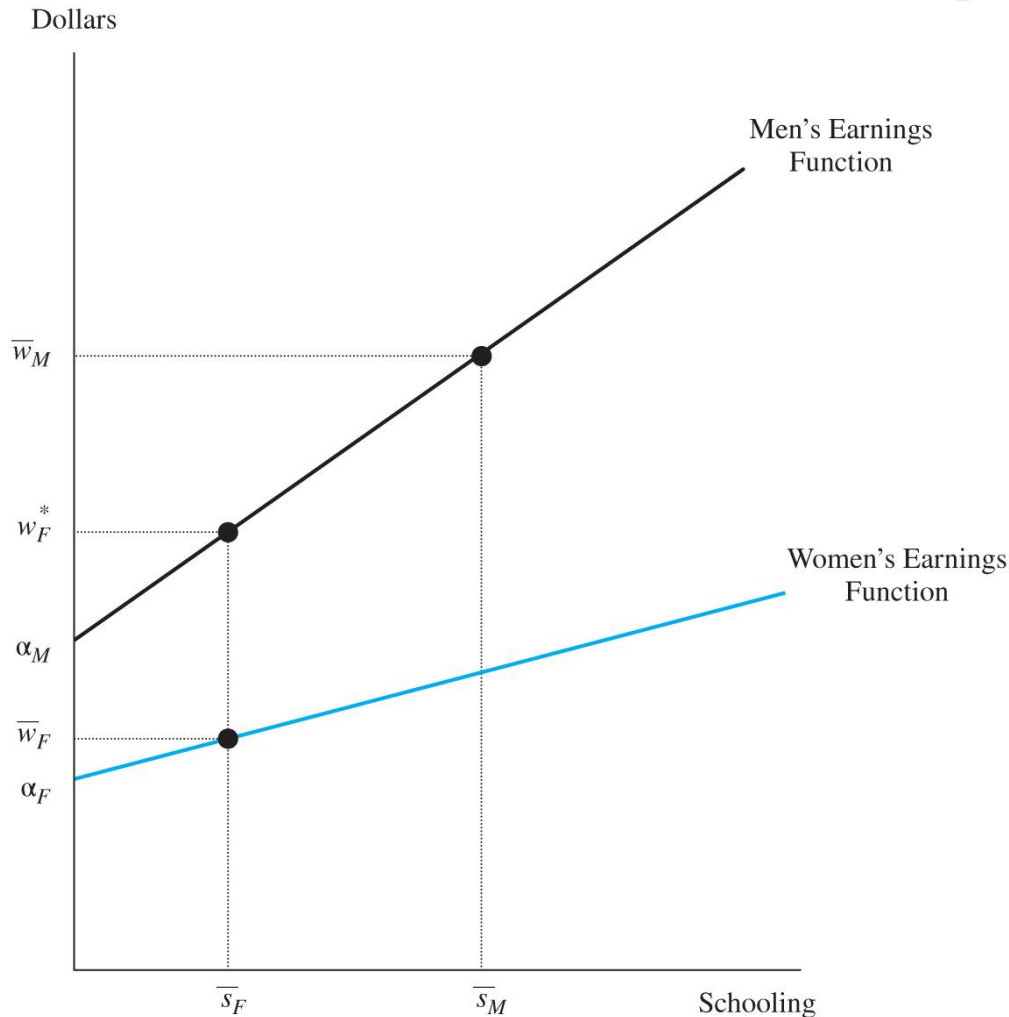
# Measuring Discrimination

One possible measure of discrimination is the difference in mean wages.

A better measure would compare the wages of equally skilled workers.

Oaxaca decomposition: a technique that decomposes the raw wage differential into a portion related to a difference in skills and a portion attributable to labor market discrimination.

# Measuring the Impact of Gender Discrimination on the Wage



The average woman has  $s_F$  years of schooling and earns  $w_F^-$ . The average man has  $s_M$  years of schooling and earns  $w_M^-$ . Part of the wage differential arises because men have more schooling than women. If the average woman was paid as if she were a man, she would earn  $w_F^*$ . A measure of discrimination is then given by  $w_F^* - w_F^-$ .

# Policy Application: Determinants of the White-Black Wage Ratio

There has been an upward trend in the wages of blacks in recent years.

This has been attributed to increases in the quality and quantity of black schooling.

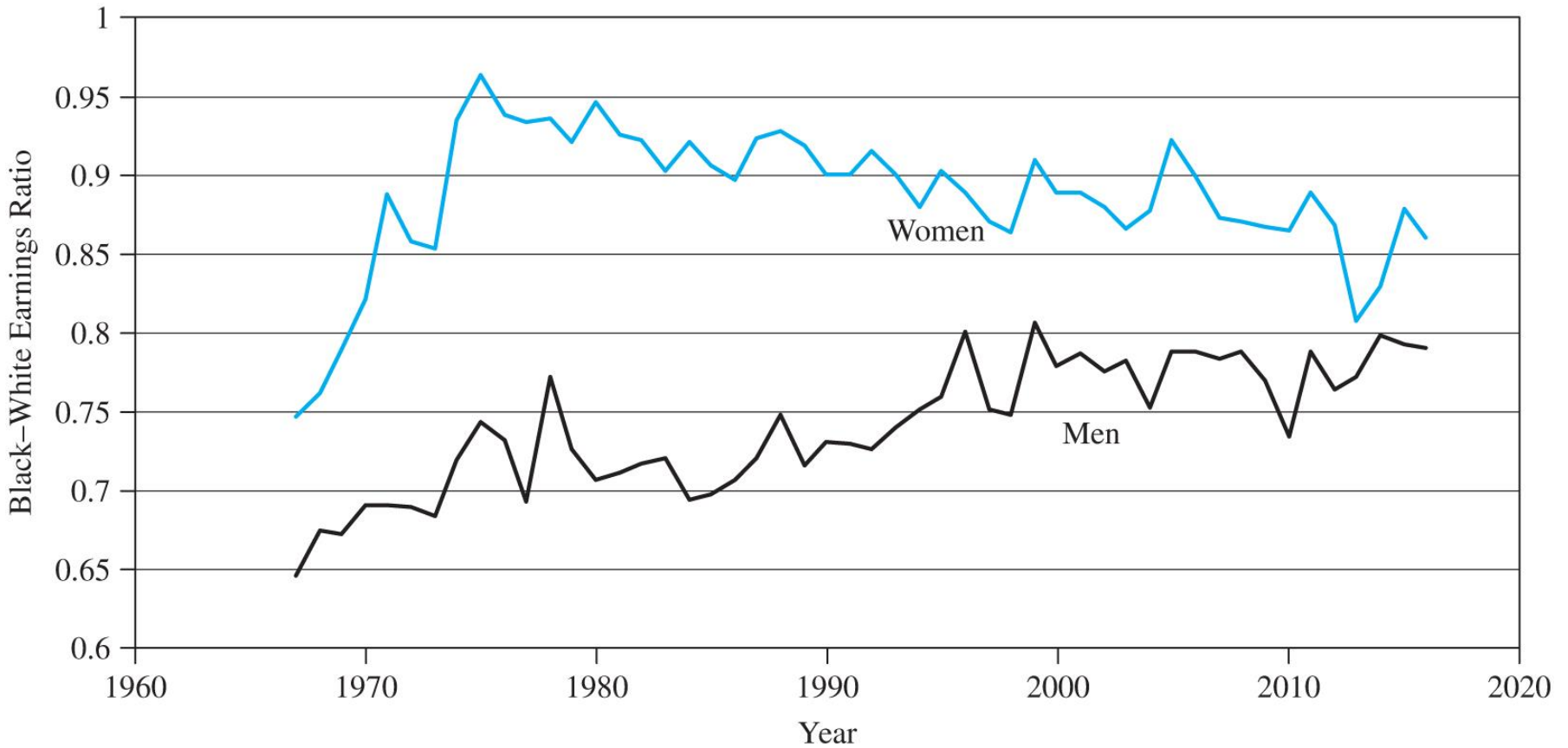
Government programs have positively affected black wages.

# The Oaxaca Decomposition of the Black-White Wage Differential, 1995

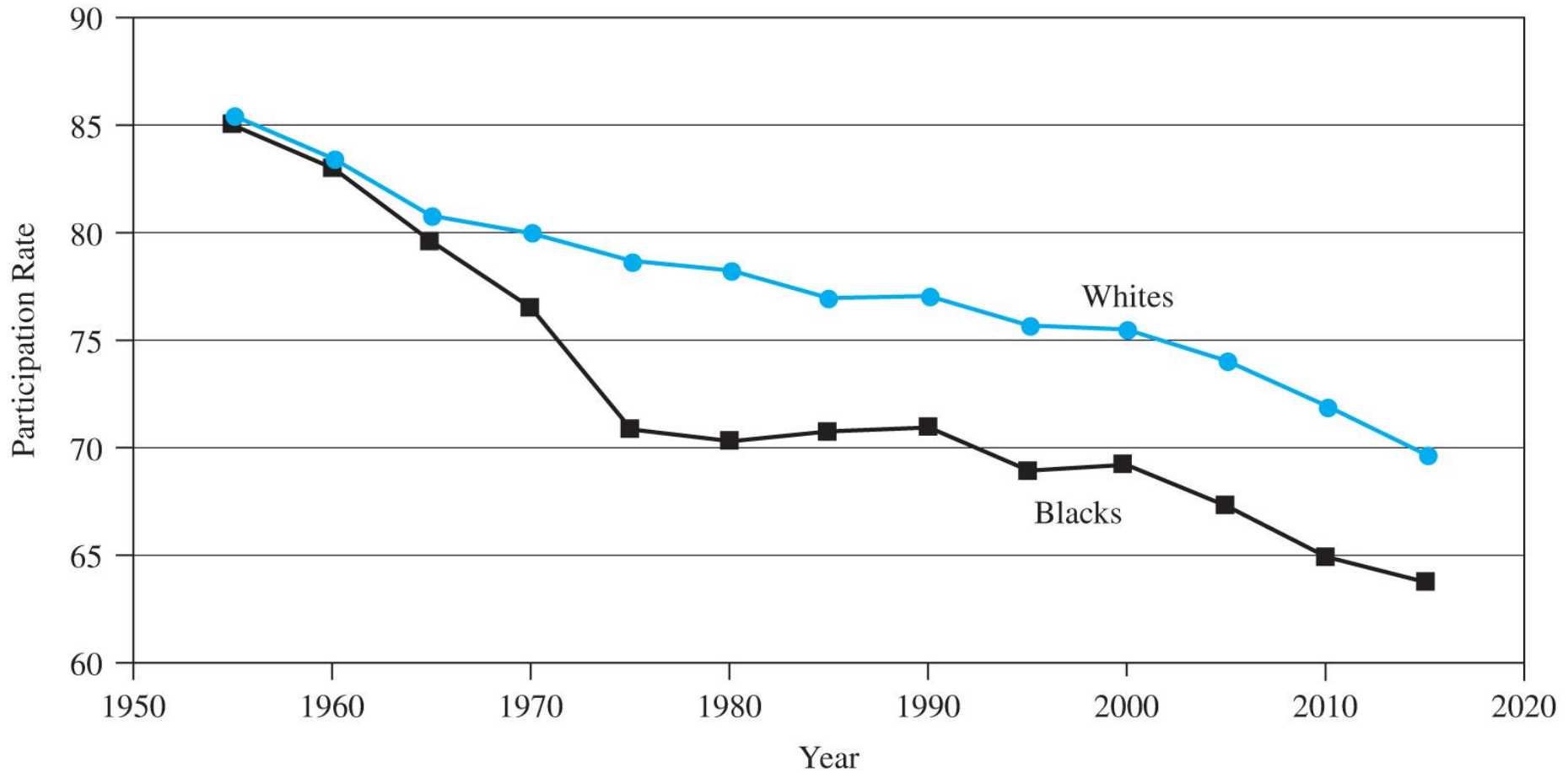
	<b>Controls for Differences in Education, Age, Sex, and Region of Residence</b>	<b>Controls for Differences in Education, Age, Sex, Region, and Occupation and Industry</b>
Raw log wage differential	-0.211	-0.211
Due to differences in skills	-0.082	-0.144
Due to discrimination	-0.134	-0.098

Source: Joseph G. Altonji and Rebecca M. Blank, "Race and Gender in the Labor Market," in Orley Ashenfelter and David Card, editors, *Handbook of Labor Economics*, vol. 3C, Amsterdam: Elsevier, 1999, Table 5. The log wage differential between any two groups can be interpreted as being approximately equal to the percentage wage differential between the groups.

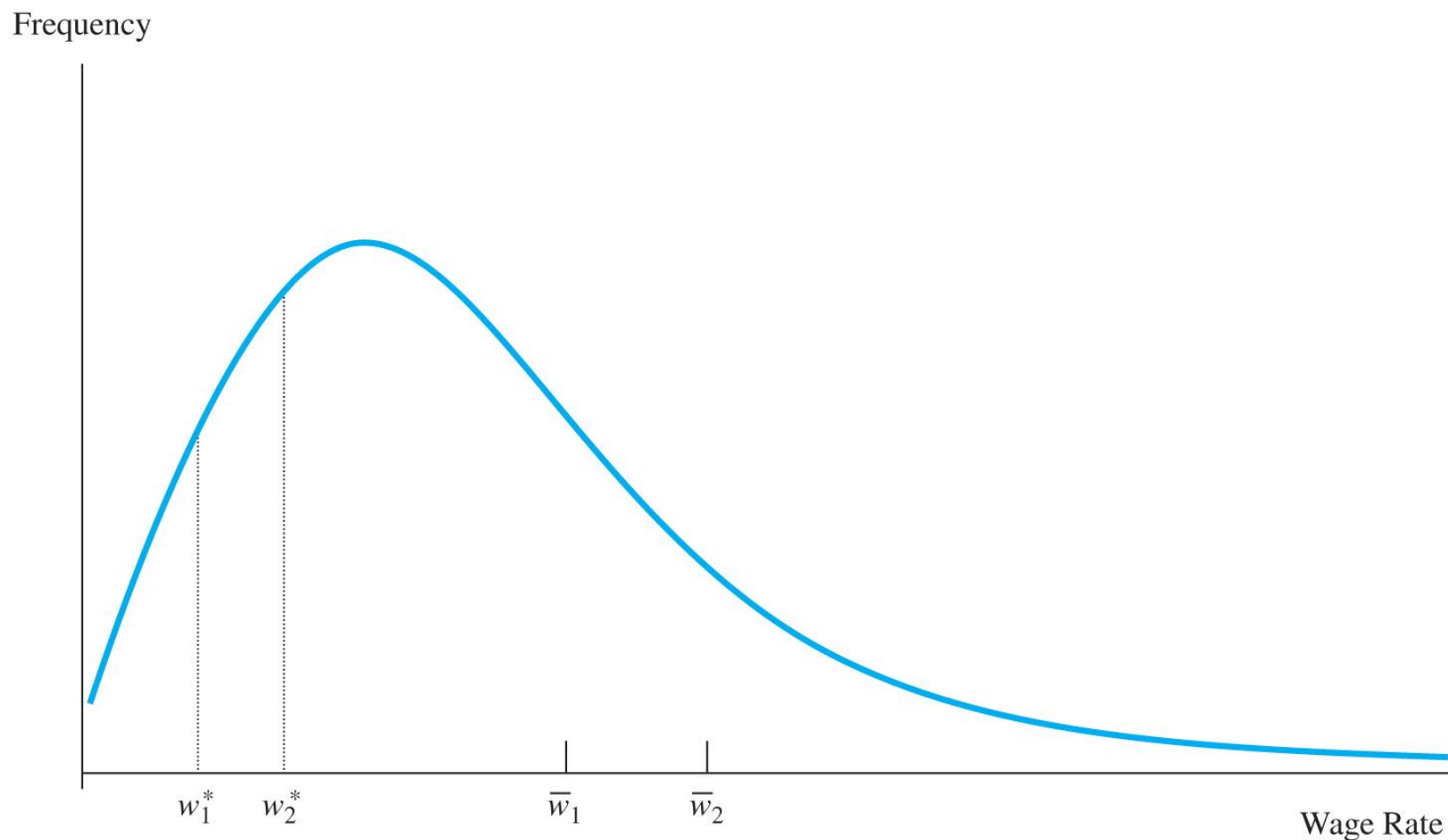
# The Trend in the Black-White Earnings Ratio, 1967-2012



# Male Labor Force Participation Rates, by Race, 1955-2010



# The Decline in the Labor Force Participation of Blacks and the Average Black Wage



# Discrimination Against Other Groups

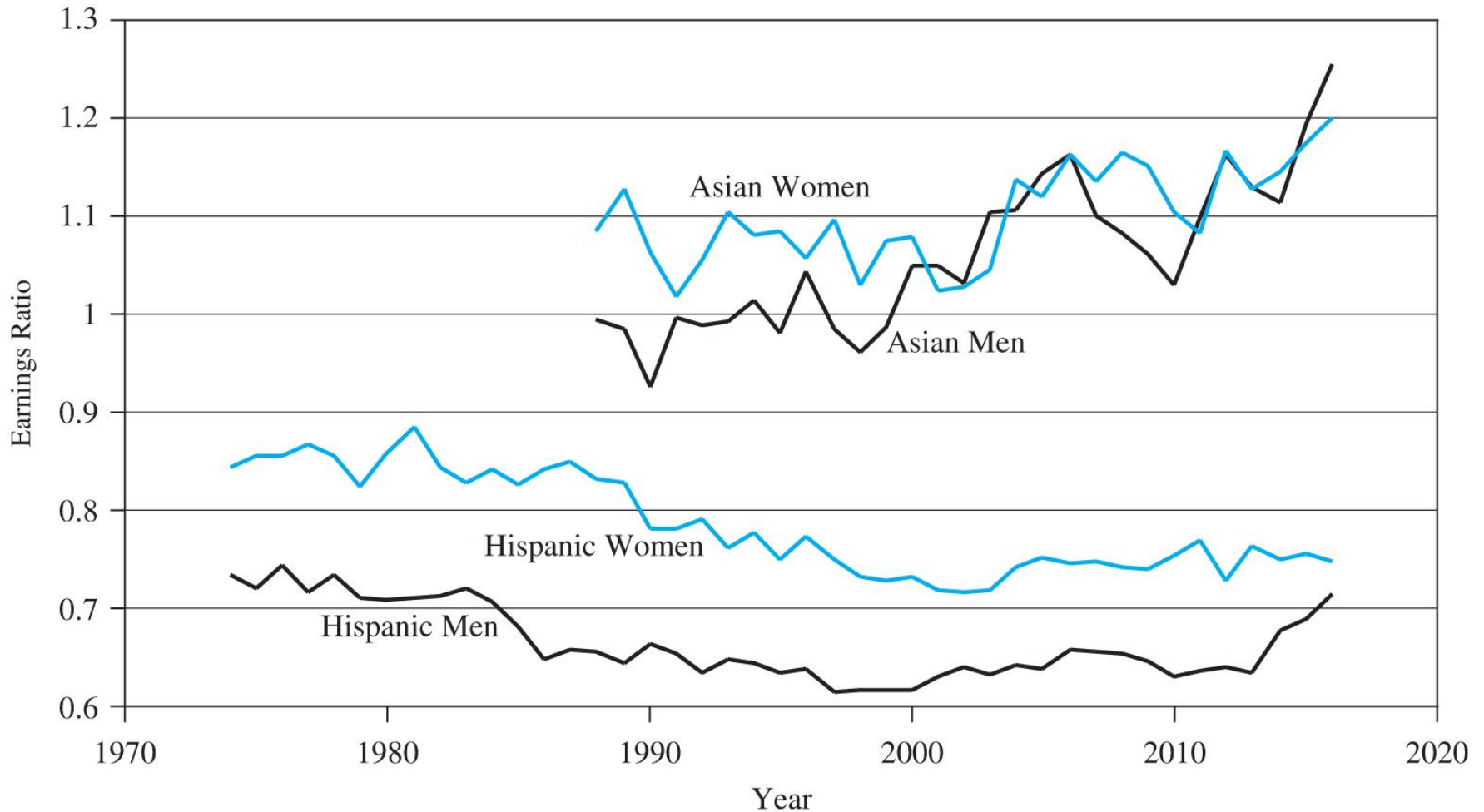
Differences in wages can be linked to varying educational attainment.

Less skilled workers earn less, just as human capital theory proposes.

Asians tend to earn more than white, mainly due to schooling.



# The Trend in the Earnings Ratio of Hispanics and Asians, 1974-2012



# Policy Application: Determinants of the Male-Female Wage Ratio

Occupational crowding has segregated women into particular occupations where the return to education is lower.

Human capital is more profitable the longer the payoff period.

Women are better off if they enter occupations in which their skills do not deteriorate during the years they spend in the household sector.

# Trend in the Female-Male Earnings Ratio, 1960-2012

