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Earnings and Discrimination

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Determinants of Equilibrium Wages

• Compensating differentials
  – Difference in wages that arises to offset the nonmonetary characteristics of different jobs
  – Higher supply of labor for “good” jobs
    • Lower equilibrium wage
  – Lower supply of labor for “bad” jobs
    • Higher equilibrium wage

"On the one hand, I know I could make more money if I left public service for the private sector, but, on the other hand, I couldn’t chop off heads."

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Human Capital

• Human capital
  – Accumulation of investments in people
    • Education
    • On-the-job training
  – Higher productivity
  – Workers with more human capital earn more
Human Capital

• Firms – demanders of labor
  – Willing to pay more for highly educated workers
    • Higher marginal products

• Workers - suppliers of labor
  – Willing to pay the cost of becoming educated
    • Only if there is a reward for doing so
Human Capital

• Wage differentials
  – Highly educated workers earn higher wages
  – Less educated workers earn lower wages
  – Compensating differential
    • Cost of becoming educated
The increasing value of skills

• **Earnings gap**
  
  – Between skilled and unskilled workers increased over the past two decades

  • Man with a college degree
    
    – 1975, 42% higher earnings than without a college degree
    
    – 2011, 75% higher earnings

  • Woman with a college degree
    
    – 1975, 35% higher earnings than without a college degree
    
    – 2011, 81% higher earnings
### Table 1
Average Annual Earnings by Educational Attainment

<table>
<thead>
<tr>
<th></th>
<th>1975</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Men</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High school, no college</td>
<td>$48,720</td>
<td>$46,038</td>
</tr>
<tr>
<td>College graduates</td>
<td>$69,146</td>
<td>$80,508</td>
</tr>
<tr>
<td>Percent extra for college grads</td>
<td>+42%</td>
<td>+75%</td>
</tr>
<tr>
<td><strong>Women</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High school, no college</td>
<td>$28,066</td>
<td>$32,249</td>
</tr>
<tr>
<td>College graduates</td>
<td>$37,804</td>
<td>$58,229</td>
</tr>
<tr>
<td>Percent extra for college grads</td>
<td>+35%</td>
<td>+81%</td>
</tr>
</tbody>
</table>

**Note:** Earnings data are adjusted for inflation and are expressed in 2011 dollars. Data apply to full-time, year-round workers age 18 and over. Data for college graduates exclude workers with additional schooling beyond college, such as a master’s degree or Ph.D.

**Source:** U.S. Census Bureau and author’s calculations.

College graduates have always earned more than workers without the benefit of college, but the salary gap has grown even larger over the past few decades.
The increasing value of skills

- **Widened earnings gap**
  - Increased demand for skilled labor relative to unskilled labor
    - Higher wages for skilled labor
    - Greater inequality
  - Two possible causes:
    - Increase in international trade
    - Changes in technology
The increasing value of skills

- Increase in international trade
  - Domestic demand for skilled labor rises
  - Domestic demand for unskilled labor falls

- Changes in technology
  - Raise the demand for skilled workers who can use the new machines
  - Reduce the demand for the unskilled workers whose jobs are replaced by the computers
Ability, Effort, and Chance

- **Natural ability**
  - Workers with greater natural ability earn more

- **Effort**
  - People who work hard are more productive and earn more

- **Chance**
  - Can influence wage
The benefits of beauty

• How prevalent are the economic benefits of beauty?
  – Labor economists Daniel Hamermesh & Jeff Biddle
  – More attractive people
    • Earn 5% more than people of average looks
  – People of average looks
    • Earn 5 to 10% more than people considered less attractive than average

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The benefits of beauty

• What explains these differences in wages?
  – Good looks- a type of innate ability
    • Determines productivity and wages
    • Attractive worker - more valuable to the firm
      – Acting, sales, and waiting on tables
      – Firm’s willingness to pay more to attractive workers
        » Reflects its customers’ preferences
The benefits of beauty

• What explains these differences in wages?
  – Reported beauty - indirect measure of other abilities
    • Dress, hairstyle, personal demeanor
      – Attributes that a person can control
      – Perhaps - more likely to be an intelligent person who succeeds at other tasks as well
  – Beauty premium - type of discrimination
Signaling

• Earn a college degree
  – No real productivity benefit
  – Signal high ability to prospective employers
    • Easier for high-ability people to earn a college degree
Signaling

- **Human-capital theory**
  - Education – workers more productive
  - Policy to increase education attainment
    - Higher productivity and wages

- **Signaling theory**
  - Education – natural ability
  - Policy to increase education attainment
    - No increase in productivity
    - No change in wages
The Superstar Phenomenon

• Superstars in the field
  – Great public appeal and astronomical incomes

• Superstars arise in markets where
  – Every customer in the market
    • Wants the good supplied by the best producer
  – The good is produced with a technology
    • That makes it possible for the best producer to supply every customer at low cost
Above-Equilibrium Wages

• Reasons for above-equilibrium wages
  – Minimum-wage laws
  – Market power of labor unions
  – Theory of efficiency wages

• Effects of above-equilibrium wages
  – Surplus of labor
  – Unemployment
Above-Equilibrium Wages

• **Union**
  – Worker association - bargains with employers over wages & working conditions

• **Strike**
  – Organized withdrawal of labor from a firm by a union

• **Efficiency wages**
  – Above-equilibrium wages paid by firms to increase worker productivity
Economics of Discrimination

• Discrimination
  – Offering of different opportunities to similar individuals who differ only by
    • Race
    • Ethnic group
    • Sex
    • Age
    • Other personal characteristics
<table>
<thead>
<tr>
<th></th>
<th>White</th>
<th>Black</th>
<th>Percent by Which Earnings Are Lower for Black Workers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Men</strong></td>
<td>$50,070</td>
<td>$39,483</td>
<td>21%</td>
</tr>
<tr>
<td><strong>Women</strong></td>
<td>$37,719</td>
<td>$33,501</td>
<td>11%</td>
</tr>
<tr>
<td><strong>Percent by Which Earnings Are Lower for Women Workers</strong></td>
<td>25%</td>
<td>15%</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Earnings data are for the year 2011 and apply to full-time, year-round workers age 14 and over.

**Source:** U.S. Census Bureau.
Economics of Discrimination

- Different groups of workers earn substantially different wages
  - Discrimination?
  - Human capital
    - Quality and quantity of education
    - Job experience
  - Kinds of work able & willing to do
  - Compensating differentials
    - Working conditions
Economics of Discrimination

• Differences in educational attainment
  – 2011, men age 25 and older
    • 32% of the white population had a college degree
    • 18% of the black population
  – 2011, women age 25 and older
    • 31% of the white population had a college degree
    • 21% of the black population
Economics of Discrimination

• Quality of public schools
  – As measured by: expenditure, class size, and so on
  – Historically: public schools in predominantly black areas have been of lower quality than public schools in predominantly white areas
Economics of Discrimination

• Human capital acquired in the form of job experience
  – Women are more likely to interrupt their careers to raise children
  – Population aged 25 to 34
    • 75% of women are in the labor force
    • 90% of men
Economics of Discrimination

• Compensating differentials
  – Men and women do not always choose the same type of work
  – Women are more likely to be secretaries
  – Men are more likely to be truck drivers
  – Different working conditions
Is Emily more employable than Lakisha?

- **Economists Marianne Bertrand & Sendhil Mullainathan**
  - Answered more than 1,300 help-wanted ads run in Boston and Chicago newspapers
  - Send in nearly 5,000 fake résumés - similar
    - Half of the résumés had names that were common in the African American community
    - The other half had names that were more common among the white population
Is Emily more employable than Lakisha?

• Results
  – Job applicants with white names
    • Received about 50% more calls
  – Discrimination occurred for all types of employers
  – Conclusion
    • “Racial discrimination is still a prominent feature of the labor market”
Discrimination by Employers

- If one group in society receives a lower wage than another group
  - Even after controlling for human capital and job characteristics
  - Who is to blame for this differential?
    - Employers - discriminatory wage differences?

- Competitive market economies
  - Natural antidote to employer discrimination: profit motive
Discrimination by Employers

- Workers differentiated by hair color
  - Blondes and brunettes
    - Same skills, experience, and work ethic
    - Discrimination: employers prefer not to hire blondes
  - Demand for blondes – lower
    - Blondes - earn a lower wage
Discrimination by Employers

• Workers differentiated by hair color
  – New firms - hire blonde workers
    • Lower wages
    • Lower production costs
    • Higher profits
  – “Brunette” firms
    • Higher production costs
    • Diminishing profits
    • Losses
Discrimination by Employers

- Workers differentiated by hair color
  - "Brunette" firms to go out of business
  - Eventually:
    - Demand for blonde workers – rises
    - Demand for brunette workers – falls
    - Wage differential disappears
  - Competitive markets
    - Have a natural remedy for employer discrimination
Segregated streetcars and the profit motive

- Early 20th century
  - Streetcars in many southern cities were segregated by race
    - White passengers sat in the front of the streetcars
    - Black passengers sat in the back
Segregated streetcars and the profit motive

• Why?
  – Laws required such segregation
  – Before these laws were passed, racial discrimination in seating was rare
  – Common to segregate smokers and nonsmokers
Segregated streetcars and the profit motive

- Firms that ran the streetcars
  - Often opposed the laws requiring racial segregation
  - Separate seating for different races
    - Raised firms’ costs
    - Reduced firms’ profit
Segregated streetcars and the profit motive

• **General lesson**
  – Business owners - more interested in making profit
    • Than in discriminating against a particular group
  – When firms engage in discriminatory practices
    • Ultimate source of the discrimination often lies not with the firms themselves but elsewhere
Economics of Discrimination

• Discrimination by customers and governments
  – Limits to the profit motive corrective abilities
  – Customer preferences (discriminatory)
    • Willing to pay to maintain the discriminatory practice
  – Government policies
    • Mandate discriminatory practices
Discrimination in sports

• Measuring discrimination is often difficult
  – Correct for differences in the productivity
• Professional sports team
  – Can measure productivity
  – Racial discrimination is common
    • Much of the blame lies with customers
      – Discriminatory wage gap can persist
      – Even if team owners care only about profit
• Market prices of old baseball cards
  – Customer discrimination