CHAPTER 19

Earnings and Discrimination

# Some Determinants of Equilibrium Wages

## Compensating Differentials

### Definition of compensating differential: a difference in wages that arises to offset the nonmonetary characteristics of different jobs.

### Jobs that are easy, fun, or safe will pay lower wages than jobs that are difficult, dull, or dangerous.

## Human Capital

### Definition of human capital: the accumulation of investments in people, such as education and on-the-job training.

### Workers with more human capital earn more on average than those with less human capital.

### Firms are willing to pay more for highly educated workers because highly educated workers have higher marginal products.

### Case Study: The Increasing Value of Skills

#### Table 1 compares the average earnings of college graduates with the average earnings of high school graduates with no additional education.

#### We can see that there has been an increase in this difference over time.

#### One possible reason that this has occurred is that international trade has changed the relative demand for skilled and unskilled labor.

#### Another possible reason is that changes in technology have changed the relative demand for skilled and unskilled workers.

### *Ask the Experts:* Inequality and Skills

### *In the News:* Schooling as a Public Investment

#### While conventional wisdom says that spending more on public education does not produce results, research shows the opposite.

#### This article from *Bloomberg* cites a study on the benefits of increased spending on public education and discusses the positive externalities of education.

## Ability, Effort, and Chance

### Because of heredity and upbringing, people differ in their physical and mental attributes. This will affect their productivity level and therefore their wage.

### People also differ in their level of effort. Those who work hard are more productive and earn a higher wage.

### Chance also plays a role in determining wages.

### Case Study: The Benefits of Beauty

#### Daniel Hamermesh and Jeff Biddle used data from surveys conducted in the United States and Canada to try to determine how wages are affected by physical appearance.

#### They found that people who are considered to be more attractive than average earned 5% more than people of average looks. People of average looks earn 5% to 10% more than people considered to be less attractive than average.

#### One possible reason for this is that good looks are important for workers who have close dealings with the public.

#### Another possible reason is that a person who is successful in making him or herself attractive may be equally successful in other tasks.

#### A third possible reason for this difference in the wages is discrimination.

## An Alternative View of Education: Signaling

### Some economists have suggested that firms may use education as a way to sort high-ability workers from low-ability workers.

### This implies that when people earn a college degree, they do not become more productive, but instead signal their high ability to prospective employers.

### This occurs because it is easier for high-ability people to get college degrees; therefore, more high-ability people get college degrees.

## The Superstar Phenomenon

### Superstars arise in markets that have two characteristics.

#### Every customer in the market wants to enjoy 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 a low cost.

### This is why we see superstars in some markets (entertainment, professional sports) and not in others (plumbing, carpentry).

## Above-Equilibrium Wages: Minimum-Wage Laws, Unions, and Efficiency Wages

### For some workers, wages are set above the level that brings supply and demand into balance.

### There are three reasons why this may be the case.

#### Minimum-wage laws that generally apply to the least skilled and least experienced workers.

#### Definition of **union: a worker association that bargains with employers over wages and working conditions.**

#### Definition of **strike: the organized withdrawal of labor from a firm by a union.**

#### Definition of **efficiency wages: above-equilibrium wages paid by firms to increase worker productivity.**

#### These higher wages often reduce worker turnover, increase worker effort, and raise the quality of workers who apply for jobs at the firm.

### Above-equilibrium wages raise the quantity of labor supplied and lower the quantity demanded, creating a surplus of labor.

# The Economics of Discrimination

## Definition of discrimination: the offering of different opportunities to similar individuals who differ only by race, ethnic group, sex, age, or other personal characteristics.

## Measuring Labor-Market Discrimination

### Table 2 reports median annual earnings by race and gender for 2017.

#### The median black man was paid 21% less than the median white man.

#### The median black woman was paid 15% less than the median white woman.

#### The median white woman was paid 20% less than the median white man.

#### The median black woman was paid 13% less than the median black man.

### However, it is difficult to determine how much of the differential in wages across different groups can be attributed to discrimination.

#### For example, the quantity of education often differs between blacks and whites.

#### It is also likely that the quality of education may differ as well.

#### Women generally have less labor market experience than men.

#### It may also be true that women take more pleasant jobs than men, leading to a compensating wage differential.

### Because the differences in median earnings among groups in part reflect differences in human capital and job characteristics, they do not by themselves say anything about how much discrimination there is in the labor market.

### Case Study: Is Emily More Employable than Lakisha?

#### Economists Marianne Bertrand and Sendhil Mullainatham answered more than 1,300 help-wanted ads run in Boston and Chicago newspapers by sending in nearly 5,000 fake resumes.

#### Half of the resumes had names that were common in the African-American community, while the other half had names that were more common among the white population. Otherwise, the resumes were similar.

#### Job applicants with “white” names received about 50% more calls from interested employers than applicants with “African-American” names.

#### More recently, economist Philip Oreopoulos sent out fake resumes with English names and with Indian, Pakistani, Chinese, and Greek names. The English sounding names got 39% more callbacks than the others.

## Discrimination by Employers

### It may be incorrect to blame employers for discrimination because each firm has a profit motive.

### Example: Two types of people, blondes and brunettes. Both groups have the same skills, experience, and work ethic. But employers prefer to hire brunettes.

#### This implies that the demand for blondes is lower than it otherwise would be.

#### This also means that blondes will earn a lower wage than brunettes.

### In this economy, there is an easy way for a firm to beat out its competitors: hire all blondes.

#### This firm would pay lower wages and therefore have lower costs.

#### Over time, we would expect more firms to follow this example.

#### The existing firms still hiring brunettes would be forced out of business due to their higher labor costs.

#### The demand for blondes increases (increasing the wage that blondes earn), while the demand for brunettes falls (decreasing the wage that brunettes earn). This will continue until the wages of the two groups are equal.

### Businesses that care about earning a profit are at an advantage when competing against those that also care about discriminating.

### Case Study: Segregated Streetcars and the Profit Motive

#### Studies of the streetcar industry suggest that streetcars were never segregated until the firms were required to do so by law.

#### In fact, many firms that ran the streetcars protested these laws because of the increase in the firms' costs from the law (which meant lower profits).

## Discrimination by Customers and Governments

### Customer preferences may limit the ability of the profit motive to eliminate discriminatory wage differentials.

#### If customers do not care whether they are being waited on by a blonde or a brunette, the profit motive will work and both groups will eventually be earning the same wage.

#### If customers prefer brunettes, the entry of firms that hire blondes will not succeed in eliminating the wage differential between blondes and brunettes.

### Also, if the government mandates discriminatory practices, then the wage differentials between the groups will continue to exist.

### Case Study: Discrimination in Sports

#### Studies of sports teams suggest that racial discrimination is common and that much of the blame lies with the customers.

#### One study found that black basketball players earned 20% less than white players of comparable ability did. Attendance at basketball games was also higher for teams with a larger proportion of white players. Even if the team owners cared only about profit, the customer discrimination makes hiring black players less profitable than white players.

#### The same situation was found in baseball in the 1960s, but more recent studies suggest that the wage differential in baseball no longer exists.

#### Even the value of baseball cards has been affected by discrimination. A 1990 study found that the cards of black hitters sold for 10% less than the cards of comparable white hitters. The cards of black pitchers sold for 13% less than the cards of comparable white pitchers.

## Statistical Discrimination

#### Statistical discrimination occurs when an irrelevant but observable characteristic is correlated with a relevant but unobservable attribute.

#### As a result, if employers have imperfect information about employee characteristics, they may discriminate against member of a group that have an undesirable characteristic on average.