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Earnings and Discrimination

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- Differences in Earnings in the United States Today
  - The typical physician earns about $200,000 a year.
  - The typical police officer earns about $50,000 a year.
  - The typical farm worker earns about $20,000 a year.

Earnings and Discrimination

- What causes earnings to vary so much?
  - Wages are governed by labor supply and labor demand.
  - Labor demand reflects the marginal productivity of labor.
  - In equilibrium, each worker is paid the value of his or her marginal contribution to the economy’s production of goods and services.

SOME DETERMINANTS OF EQUILIBRIUM WAGES

- Compensating differentials
- Human capital
- Ability, effort, and chance
- Signaling
- The superstar phenomenon

Compensating Differentials

- *Compensating differential* refers to a difference in wages that arises from nonmonetary characteristics of different jobs.
  - Coal miners are paid more than others with similar levels of education.
  - Night shift workers are paid more than day shift workers.
  - Professors are paid less than lawyers and doctors.

Human Capital

- *Human capital* is the accumulation of investments in people, such as education and on-the-job training.
- The most important type of human capital is education.

Human Capital

- Education represents an expenditure of resources at one point in time to raise productivity in the future.
- By the year 2000, a man with a college degree earned more than 89 percent more than without one. Women showed a 70 percent increase in earnings due to a college degree.

Table 1 Average Annual Earnings by Educational Attainment

	1980	2000
Men		
High school, no college	$36,430	$36,770
College graduates	$52,492	$69,421
Percent extra for college grads	+44%	+89%
Women		
High school, no college	$21,969	$24,970
College graduates	$29,663	$42,575
Percent extra for college grads	+35%	+70%

Note: Earnings data are adjusted for inflation and are expressed in 2000 dollars. Data apply to full-time, year-round workers age 18 and over. Data for college graduates exclude workers with additional schooling beyond college.

Source: U.S. Bureau of the Census and author's calculations.

Ability, Effort, and Chance

- Why has the gap in earnings between skilled and unskilled workers risen in recent years?
  - International trade has altered the relative demand for skilled and unskilled labor.
  - Changes in technology have altered the relative demand for skilled and unskilled labor.

Ability, Effort, and Chance

- Natural ability is important for workers in all occupations.
- Many personal characteristics determine how productive workers are and, therefore, play a role in determining the wages they earn.

An Alternative View of Education: Signaling

- Firms use educational attainment as a way of sorting between high-ability and low-ability workers.
  - It is rational for firms to interpret a college degree as a signal of ability.

The Superstar Phenomenon

- Superstars arise in markets that exhibit the following 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.

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

- Why are some workers’ wages set above the level that brings supply and demand into equilibrium?
  - Minimum-wage laws
  - Market power of labor unions
  - Efficiency wages

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

- Unions
  - A *union* is a worker association that bargains with employers over wages and working conditions.
- Strike
  - A *strike* refers to the organized withdrawal of labor from a firm by a union.

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

- Efficiency Wages
  - The theory of *efficiency wages* holds that a firm can find it profitable to pay high wages because doing so increases the productivity of its workers. High wages may:
    - reduce worker turnover.
    - increase worker effort.
    - raise the quality of workers that apply for jobs at the firm.

THE ECONOMICS OF DISCRIMINATION

- *Discrimination* occurs when the marketplace offers different opportunities to similar individuals who differ only by race, ethnic group, sex, age, or other personal characteristics.

THE ECONOMICS OF DISCRIMINATION

- Although discrimination is an emotionally charged topic, economists try to study the topic objectively in order to separate myth from reality.

Measuring Labor-Market Discrimination

- Discrimination is often measured by looking at the average wages of different groups.

Measuring Labor-Market Discrimination

- Even in a labor market free of discrimination, different people have different wages.

Measuring Labor-Market Discrimination

- People differ in the amount of human capital they have and in the kinds of work they are willing and able to do.

Measuring Labor-Market Discrimination

- Simply observing differences in wages among broad groups—white and black, men and women—says little about the prevalence of discrimination.

Table 2 Median Annual Earnings by Race and Sex

	White	Black	Percent Earnings Are Lower for Black Workers
Men	$38,870	$30,403	22%
Women	28,080	25,107	11%
Percent Earnings Are Lower for Women Workers	28%	17%	

Note: Earnings data are for the year 2000 and apply to full-time, year-round workers aged 14 and over.

Source: U.S. Bureau of the Census.

Measuring Labor-Market Discrimination

- Because the differences in average wages 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.

Discrimination by Employers

- Firms that do not discriminate will have lower labor costs when they hire the employees discriminated against.

Discrimination by Employers

- Nondiscriminatory firms will tend to replace firms that discriminate.

Discrimination by Employers

- Competitive markets tend to limit the impact of discrimination on wages.
- Firms that do not discriminate will be more profitable than those firms that do discriminate.

Discrimination by Customers and Governments

- Although the profit motive is a strong force acting to eliminate discriminatory wage differentials, there are limits to its corrective abilities.
  - Customer preferences
  - Government policies

Discrimination by Customers and Governments

- Customer preferences:
  - If customers have discriminatory preferences, a competitive market is consistent with a discriminatory wage differential.
  - This will happen when customers are willing to pay to maintain the discriminatory practice.

Discrimination by Customers and Governments

- Government policies:
  - When the government mandates discriminatory practices or requires firms to discriminate, this may also lead to discriminatory wage differentials.

Summary

- Workers earn different wages for many reasons.
- To some extent, wage differentials compensate workers for job attributes.
- Workers with more human capital get paid more than workers with less human capital.

Summary

- The return to accumulating human capital is high and has increased over the past decade.
- There is much variation in earnings that cannot be explained by things economists can measure.

Summary

- The unexplained variation in earnings is largely attributable to natural ability, effort, and chance.
- Some economists have suggested that more-educated workers earn higher wages because workers with high natural ability use education as a way to signal their high ability to employers.

Summary

- Wages are sometimes pushed above the equilibrium level because of minimum-wage laws, unions, and efficiency wages.
- Some differences in earnings are attributable to discrimination on the basis of race, sex, or other factors.
- When measuring the amount of discrimination, one must correct for differences in human capital and job characteristics.

Summary

- Competitive markets tend to limit the impact of discrimination on wages.
- Discrimination can persist in competitive markets if customers are
  - willing to pay more to discriminatory firms,
  - or if the government passes laws requiring firms to discriminate.