Diversity Yes, Force No: How Markets Punish Workplace Racism

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This paper argues that a primary cause of racist outcomes in the workplace is the degree of explicit or implicit protectionism employers receive. When this occurs, employers are protected from market penalties that would otherwise increase the costs associated with workplace discrimination and reduce profits. Examples from U.S. economic history are provided to support the argument that wage differences in competitive markets can be explained by differences in worker productivity and that wage differences between whites and blacks did not significantly diverge until after labor market interventions had the effect of protecting employers from market penalties resulting from such actions.

INTRODUCTION

Workplace discrimination has long been a focus in the economics literature, at least starting with Shaw (1892), which discusses complaints about discrimination by Illinois mineworkers who refused to utilize company stores. More recently, N. Gregory Mankiw, writing in his best-selling Intermediate Macroeconomics textbook, argues that workplace discrepancies between whites and non-whites (measured in unemployment rates) reflect "unequal access to informal job-finding networks and discrimination by employers." (Mankiw, 2013, p. 193)

However, this paper argues that Mankiw's explanation for discrepancies on racism is insufficient, and that racism is not always a necessary or sufficient condition to explain such discrepancies. Rather, it argues that it is the lack of market forces that hinder employer discrimination for whatever reason (including racism) that cause such outcomes to occur, and that often, its reduction is based on changing the institutional settings that characterize the workplace, which requires reforming institutions that protect labor from market competition both for its labor input and for its market output. This implies that workplace legislation that promotes labor market competition first and foremost can achieve the same workplace outcomes intended by those groups in society that favor increased levels of diversity in the labor force.

This paper is organized as follows. The next section presents some of the important recent contributions to the economics literature on workplace racism. Section Three presents the economic explanation for why market forces reduce the tendency for workplace discrimination for any reason (including racism) to persist. The implication is that while less *prima facie* evidence of discrimination may result, racism itself is not necessarily eradicated by market forces and it may express itself in other, non-market venues. The last section offers some concluding remarks.

ECONOMIC EXPLANATIONS FOR WORKPLACE RACISM

The economics of racism has generated much intellectual output in the economics literature, with the most prominent of the modern literature produced by Becker (1971), in which Becker argues that workplace disparities can result from discrimination, and when they do, they lower the income of both the party being discriminated against as well as that of the discriminating party. The predilection to favor one race over another is treated, however, as a taste, and analyzed as such within the traditional neoclassical economic framework. In pursuing this taste, the individual acts as though "he were willing to pay something, either directly or in the form of reduced income, to be associated with some persons instead of others." (Becker, 1971, p. 6) From this perspective, racism is irrational and also difficult to maintain when acted on in a competitive economy.

Later research attempts to provide some rational for racism. Phelps (1972), Arrow (1973), and Kübler (1997) present research that considers workplace racism a low-cost method for ascertaining quality in the workplace. Durlauf (2005) applies this analysis to racial profiling, and finds that such discrimination reflects decision-making under ambiguity. Extending this analysis, Goldsmith, Hamilton, & Darity (2006) present research that suggest that the differences in labor market outcome are explained not only by differences between white and nonwhite workers in the labor force, but also between the performance of dark-skinned blacks and lighter-skinned blacks.

However, there are other explanations for disparate outcomes in the workplace. Lang, Manove, & Dickens (2005) show that wage differentials are more likely when wages for advertised jobs are posted, in part because the perception that discrimination exists causes nonwhites to apply for lower-advertised wage positions. Bertrand & Mullainathan (2004) present the results of a study that suggests that employers are more likely to respond to applicants with "white-sounding" names, and that disparities develop regardless of occupation, industry, and employer size.

Finally, some research argues that racially disparate outcomes in the workplace may have other, more significant explanations than racism. Lundberg & Startz (1998) emphasize the role of human capital and find that community human capital effects dominate in explaining workplace discrepancies, even in the absence of racism. Meanwhile, Calvó-Armengol, & Jackson (2004) emphasize the role of social networks in explaining workplace outcomes.

MARKETS HINDER WORKPLACE RACISM

As pervasive and as egregious as racism is, economic theory suggest that it cannot explain in market outcomes in the long run, because racist employers eventually incur market penalties, and that where racism perseveres in the marketplace, we can assume that extra-market intervention allows it. A much more important factor explaining wage differentials is not skin color but skills and, by extension, productivity. An illustration of this outcome can be found in wage differentials between West Indian blacks and American blacks, with the former's relative success suggesting that wage differences have other causes than melanin content.

In the post-bellum American South, labor markets were flooded with relatively unskilled (or at least narrowly-trained) blacks. Since any individual freeman's contribution to overall aggregate productivity was small (measured in terms of his marginal revenue product), his wages would reflect this fact. However, that does not mean that his wages were lower than those of unskilled whites. This tended not to be the case because wages reflect a worker's marginal productivity, regardless of whether racist attitudes dominated society.[1]

Why is this? Assume that an employer in rural, post-bellum America chooses to discriminate and pay an unskilled white worker a higher wage than an unskilled black worker. The employer would be hurt in two ways. First, if the white worker's wage exceeded his marginal contribution to the productive process, then the employer would be losing money by employing this worker. If the worker contributed $5 a week in revenue to the total productivity, but was paid $7, the employer lost $2 by hiring him. Second, the employer was clearly not profit-maximizing and would attract competition from more efficient competitors drawn by the opportunity to produce the same output at a lower cost.

In the same way, if the same employer paid a black worker a wage that was less than his marginal contribution to the productive process, the employer would benefit—until his actions attract competition that would then bid away these underpaid workers. None of this analysis suggests that racism cannot harm minorities in the workforce, at least in the short run, but over the long run, decisions to engage in this kind of activity are punished. Indeed, one of the reasons for the migration of blacks to labor forces in the cities, beginning soon after emancipation, was because of the existence of more competitive labor markets there. In such a situation, racist employers would be penalized.

Significant wage differentials among unskilled workers do not start showing up until the application of non-market forces on the workplace, initially with the rise of trade unionism but especially with the passage of minimum wage legislation. (See Table 1.) Prior to the first federal minimum wage bill passed on the 1930s, there was virtually no difference between black and white teenage (i.e., unskilled) unemployment, at a time when many assume that racism was more prevalent than today. After the minimum age bill is passed, however, we witness an increase in black teenage unemployment relative to whites, since as employers are now forced to pay a wage that is higher than the value of many workers' marginal revenue product, they no longer incur a market penalty for allowing racism to dictate their market decisions.

TABLE 1
U.S. UNEMPLOYMENT RATES OF WHITE AND NON-WHITE WORKERS, 1890-2010

YEAR	WHITE	NON-WHITE	DIFFERENCE
1890	4.41	4.07	-0.34
1900	6.47	7.57	1.10
1930	6.59	6.07	-.052
1940	9.50	10.89	1.39
1950	4.9	9.0	4.1
1955	3.9	8.7	4.8
1960	5.0	10.5	5.2
1965	4.1	8.1	4.0
1970	4.5	8.2	3.7
1975	7.8	13.8	6.0
1980	6.3	13.1	6.8
1985	6.2	13.7	7.5
1990	4.7	10.1	5.4
1995	4.9	9.6	4.7
2000	3.5	7.6	4.1
2005	4.4	10.0	5.6
2010	8.7	16.0	7.3

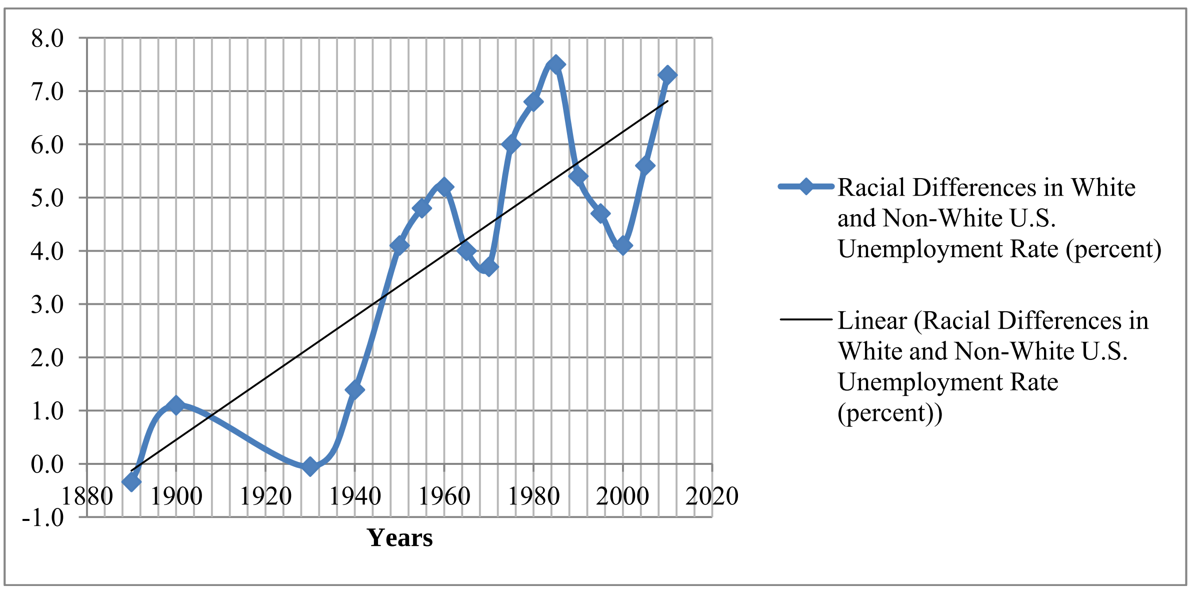
Source: Vedder and Galloway [1993, p. 272]; Economic Report of the President, Appendix B [2012, p. 368]; U.S. Department of Labor (Bureau of Labor Statistics). Data for years 2000, 2005, and 2010 represent Black or African American only.

When differences in unemployment rates are plotted along this time period from 1890 to 2010, racial differences are particularly striking. With the y-axis representing differences in unemployment rates between whites (lower rates of unemployment) and non-white (higher rates of unemployment) and the x-axis time period in years, the association over time may be plotted linearly. While racial differences in unemployment wax and wane over time, the trend is strongly upward, especially during periods of marked government intervention in labor markets. (See Figure 1.) Thus, beginning in the 1930s as non-market forces begin to permeate the workplace, including the imposition of the first federal minimum wage, wage differentials expanded. Similar outcomes occurred during the Great Society and again during the post-9/11 labor market.

Unskilled blacks suffered from this state intervention in labor markets in many ways. Priced out of jobs, they were unable to earn a legal income that they would have earned otherwise. To the extent that they were shut out of the labor force, many were unable to acquire the skills necessary to earn a larger income in the future. Meanwhile, they were more likely to become dependent on government transfer programs. None of this would have happened had the federal government not intervened in voluntary exchanges between labor suppliers and demanders.[2]

Interestingly, when these blacks reached their twenties, we see unemployment rates plummet, despite the fact that their skin color had not changed. This happened because many eventually learned productivity-enhancing skills. The intervention in labor markets in the form of minimum wage legislation protected racist employers from the market forces that would have otherwise penalized their actions. As Henry Hazlitt (1952) reminds us, the good economist will consider the full effect of such policies.[3]

FIGURE 1
RACIAL DIFFERENCES IN U.S.UNEMPLOYMENT RATES OF WHITE AND NON-WHITE, 1890-2010



Source: Vedder and Galloway (1993, p. 272); Economic Report of the President, Appendix B (2012, p. 368); U.S. Department of Labor (Bureau of Labor Statistics)

It follows, of course, that any intervention in labor markets has similar effects. So when the federal government passes laws that penalize employers for firing employees from some legally-protected group, we see increases in unemployment on the part of employees from the legally-protected group, which reflects the increased relative costs of hiring them. This explains why temp agencies are now among the largest employers in the United States today. Temp agencies allow employers to evaluate new employees, and reject them if they are not satisfactory, without legal penalty, because these workers remain under the legal employment of the agency, not the rejecting firm. It also follows that in a modern, global economy, where any uncompetitive policy threatens firm survival, workplace racism is even less likely. Wage policies that pay workers less or more than the marginal revenue they bring to their firms are penalized more quickly than they would have even 25 years ago. Indeed, global capitalism makes bureaus such as the Equal Employment Opportunity Commission less unnecessary.

CONCLUDING OBSERVATIONS

While there are many institutional settings that may reward workplace discrimination, the long-run economic data suggests that less regulated workplaces show less evidence of it, because it forces employers acting on such impulses to pay a direct monetary price for it, reducing revenues and market shares. Where we see evidence of workplace racism in a modern market economy is either a short-run phenomenon that has not yet been penalized, or it reflects a portion of the market that receives some protection from competition. This is why, following the research of Reynolds (1984), unionized labor markets (automobiles in the North or steel in the South, for instance), were traditionally dominated by white workers, whereas the non-unionized labor forces not receiving extra-market protection, tended to be more integrated.

Increased exposure to market forces does not eradicate racism which, after all, has deep roots in the human experience. However, such exposure can minimize racism's pernicious effects in the workplace. Any intervention in the market process that increases the cost of labor can have the effect of increasing incidence of racially disparate outcomes to the extent that these interventions protect employers who would otherwise discriminate on the basis of racial biases from the full cost of their decisions. This implies that laws that are enacted to promote diversity in the workplace may actually have the effect of reducing it.

ENDNOTES

1. For an account contemporary to this time period, see Bemis (1893).

2. That many blacks in the 1930s expected increases in workplace racism is explained in Bernstein (2001). Also, consider a cartoon by Rogers (1934) that appeared in the black Chicago newspaper, the *Chicago Defender*, during Franklin D. Roosevelt's first term. In the first panel, a man says to his wife, "Dear, the Old Factory is Now a Member of the 'NRA' which means better wages and better hours!" In the second panel, men crowd a factory before work, reading a sign that says "UNDER THE 'NRA' THIS FACTORY SHALL ADVANCE WAGES AND MINIMIZE HOURS OF ALL EMPLOYEES. HENCEFORTH WE SHALL EMPLOY WHITE HELP ONLY". The more recent plea by Asian business leaders to repeal the city of Seattle's $15 minimum wage law (Ethnic Community Coalition, 2014) was motivated partly out of a similar recognition of likely racially discriminatory outcomes of that legislation.

3. Hazlitt writes (p. 3), "In addition to these endless pleadings of self-interest, there is a second main factor that spawns new economic fallacies every day. This is the persistent tendency of men to see only the immediate effects of a given policy, or its effects only on a special group, and to neglect to inquire what the long-run effects of that policy will be not only on that special group but on all groups. It is the fallacy of overlooking secondary consequences."

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