



# Earnings and Discrimination

## Chapter 19

# **Differences in Earnings in the U.S. 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.**

# **What causes earnings to vary so much?**

- ◆ **Wages are governed by labor supply and labor demand.**
- ◆ **Labor demand reflects the marginal productivity of labor.**

# **What causes earnings to vary so much?**

- ◆ 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 differentials refer to differences 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.**
- ◆ **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.**
- ◆College graduates in the U.S. earn about 65 percent more than workers with a high school diploma.**



# Average Annual earnings by Educational Attainment

	1978	1998
<b>Men</b>		
High school, no college	\$31,847	\$28,742
College graduates	\$52,761	\$62,588
Percent extra for college grads	+66 percent	+118 percent
<b>Women</b>		
High school, no college	\$14,953	\$17,898
College graduates	\$23,170	\$35,431
Percent extra for college grads	+55 percent	+98 percent

# **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**



# **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.**

**Why are, for some workers, wages set above the level that brings supply and demand into equilibrium?**

- ◆ **Minimum-wage laws**
- ◆ **Market power of labor unions**
- ◆ **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.**

# **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.**

# **Economic Forces and Discrimination**

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

# **Economic Forces and Discrimination**

**Nondiscriminatory firms will  
tend to replace firms that  
discriminate.**



# **Economic Forces and Discrimination**

- ◆ **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.**

# **The Debate Over Comparable Worth**

**According to the doctrine of comparable worth, jobs deemed comparable should be paid the same wage.**

# **The Debate Over Comparable Worth**

**Advocates of comparable worth want jobs to be rated according to a set of impartial criteria such as education, experience, responsibility, working conditions, and so on.**

# **The Debate Over Comparable Worth**

**Critics of comparable worth argue that a competitive market is the best mechanism for setting wages.**