

19 Earnings and Discrimination

PRINCIPLES OF ECONOMICS FOURTH EDITION

N. GREGORY MANKIW

Premium PowerPoint® Slides
by Ron Cronovich

2008 update
Modified by Joseph Tao-yi Wang

© 2008 South-Western, a part of Cengage Learning, all rights reserved

In this chapter, look for the answers to these questions:

- How do wages compensate for differences in job characteristics?
- Why do people with more education earn higher wages?
- Why are wages sometimes above their equilibrium values?
- Why is it difficult to measure discrimination?
- When might the market solve the problem of discrimination? When might it not?

CHAPTER 19 EARNINGS AND DISCRIMINATION

1

U.S. Median Weekly Earnings, Selected Occupations, 2006

occupation	both sexes	men	women	gender gap
Chief executives	\$1,875	\$1,907	\$1,422	34.1%
Aircraft pilots	1,407	1,419	<i>n.e.d.</i>	
Educ. administrators	1,125	1,275	1017	25.4%
Fire fighters	912	918	<i>n.e.d.</i>	
Registered nurses	978	1,074	971	10.6%
Social workers	732	749	728	2.9%
Secretaries	583	559	584	-4.3%
Telemarketers	395	<i>n.e.d.</i>	<i>n.e.d.</i>	
Waiters/waitresses	363	401	348	15.2%
Maids/housekeeping	355	404	348	16.1%

n.e.d. = not enough data for BLS disclosure requirements

2

Taiwan Average Monthly Earnings, Sel. Occup., 2007/10

occupation	both sexes	men	women	gender gap
外國銀行業	\$82,618	\$102,265	\$75,021	36.3%
能源礦業	78,511	79,765	69,744	14.4%
電力供應業	74,526	75,522	66,129	14.2%
航空運輸業	74,470	95,751	53,759	78.1%
醫療保健服務業	52,823	91,103	42,854	112.6%
專業、科學及技術服務業	51,149	55,352	46,980	17.8%
法律服務業	43,630	43,950	43,244	1.6%
廣告業	44,068	43,009	44,906	-4.2%
理容美髮業	27,711	25,471	27,905	-8.7%
餐飲業	22,996	25,153	21,572	16.6%

Introduction

- In competitive markets, the wages workers earn equal the value of their marginal products.
- There are many factors that affect productivity and wages...

CHAPTER 19 EARNINGS AND DISCRIMINATION

4

Compensating Differentials

- **Compensating differential:** a difference in wages that arises to offset the nonmonetary characteristics of different jobs
- These characteristics include unpleasantness, difficulty, safety. Examples:
 - Coal miners and fire fighters are paid more than other workers with similar education to compensate them for the extra risks.
 - Night shift workers paid more than day shift to compensate for the lifestyle disruption of working at night.

CHAPTER 19 EARNINGS AND DISCRIMINATION

5

Ability, Effort, and Chance

- Greater ability or effort often command higher pay, as these increase workers' marginal products, make them more valuable to the firm.
- Wages also affected by chance
 - e.g., new discoveries that no one could have predicted make some occupations obsolete, increase demand in others

Ability, Effort, and Chance

- Ability, effort, and chance are difficult to measure, so it is hard to quantify their effects on wages.
- They are probably important, though, since easily measurable characteristics (education, age, etc.) account for less than half of the variation in wages in our economy.

Case Study: The Benefits of Beauty

Research by Hamermesh and Biddle:

- People deemed more attractive than average earn 5% more than people of average looks.
- Average-looking people earn 5-10% more than below-average looking people.

Case Study: The Benefits of Beauty

Hypotheses:

- Good looks matter for productivity
 - In jobs where appearance is important, attractive workers are more valuable to the firm, command higher pay.
- Good looks indirectly related to ability
 - People who make an effort to project attractive appearance may be smarter or more competent in other ways.
- Discrimination

The Superstar Phenomenon

- Superstars like Tom Hanks, U2 earn many times more than average in their fields.
- The best plumbers or carpenters do not.
- 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 allows the best producer to supply every customer at a low cost.

Human Capital

- **Human capital:** the accumulation of investments in people, such as education and on-the-job training
- Human capital affects productivity, and thus labor demand and wages.

Weekly Earnings of Full-Time Employed Persons Age 25+ by Education, 2007:Q4

Educational attainment	Median weekly earnings
Less than H.S.	\$ 424
H.S. diploma	610
Some college or Associate degree	697
Bachelor's degree	994
Advanced degree	1,259

12

Weekly Earnings of Full-Time Employed Persons Age 25+ by Education, 2006:Q4

Educational attainment	Median weekly earnings	TAIWAN data (\$1=NT\$33)
P. S. and below	\$ 415	\$ 230
Mid. school (vocal.)		308
S. vocational school		338
H.S. diploma	597	363
Associate/Some col.	700	431
Bachelor's degree	966	514
Advanced degree	1,217	

13

The Increasing Value of Skills



The earnings gap between college-educated and non-college-educated workers has widened in recent decades.

Percentage difference in annual earnings for college graduates vs. high school diploma		
	1980	2003
Men	44%	82%
Women	35%	71%

CHAPTER 19 EARNINGS AND DISCRIMINATION

14

The Increasing Value of Skills



Taiwan also has an earnings gap between college-educated and non-college-educated workers.

Percentage difference in annual earnings for advance degrees in Taiwan (2006)		
	Associate	≥ Bachelor
vs. High S.	19%	42%
vs. J. High	40%	67%

15

The Increasing Value of Skills

Two hypotheses:

- 1. International trade**
Rising exports of goods made with skilled labor, rising imports of goods made with unskilled labor.
- 2. Skill-biased technological change**
New technologies have increased demand for skilled workers, reduced demand for unskilled workers.

Difficult to determine which hypothesis better explains the widening earnings gap; probably both are important.

CHAPTER 19 EARNINGS AND DISCRIMINATION

16

ACTIVE LEARNING 1: Discussion question

Suppose you were offered this choice:

- You could spend 4 years studying at the world's best university, but you would have to keep your attendance there a secret.
- You could be awarded an official degree from the world's best university, but you couldn't actually study there.

Which do you think would enhance your future earnings more?

17

The Signaling Theory of Education

An alternative view of education:

- Firms use education level to sort between high-ability and low-ability workers.
- The difficulty of earning a college degree demonstrates to prospective employers that college graduates are highly capable.
- Yet, the education itself has no impact on productivity or skills.
- Policy implication: Increasing general educational attainment would not affect wages.

Reasons for Above-Equilibrium Wages

1. Minimum wage laws

The minimum wage may exceed the eq'm wage of the least-skilled and experienced workers

2. Unions

Union: a worker association that bargains with employers over wages and working conditions
Unions use their market power to obtain higher wages; most union workers earn 10-20% more than similar nonunion workers.

Reasons for Above-Equilibrium Wages

3. Efficiency wages

Efficiency wages: above-equilibrium wages paid by firms to increase worker productivity

Firms may pay higher wages to reduce turnover, increase worker effort, or attract higher-quality job applicants.

ACTIVE LEARNING 2: Explaining wage differentials

In each case, identify which worker would earn more and explain why.

- A. The best physical therapist on the planet or the best writer on the planet
- B. A trucker that hauls produce or a trucker that hauls hazardous waste from nuclear power plants
- C. A graduate of an Ivy League college or an equally intelligent & capable graduate of a state university
- D. Someone who graduated from a state university with a 3.7 GPA, or someone who graduated from the same university with a 2.4 GPA

ACTIVE LEARNING 2: Answers

- A. The best physical therapist on the planet or the best writer on the planet

*The superstar phenomenon:
The best writer can service many more customers than the best physical therapist.*

- B. A trucker that hauls produce or a trucker that hauls hazardous waste from nuclear power plants

*Compensating differentials:
The hazardous waste hauler earns more to compensate for the higher risks.*

ACTIVE LEARNING 2: Answers

- C. A graduate of an Ivy League college or an equally intelligent & capable graduate of a state university

*The signaling theory of education:
Employers assume the Ivy League grad has more ability than the state university grad.*

- D. Someone who graduated from a state university with a 3.7 GPA, or someone who graduated from the same university with a 2.4 GPA

*The human capital theory of education:
A higher GPA reflects greater learning, which leads to higher productivity and wages.*

The Economics of Discrimination

- **Discrimination:** the offering of different opportunities to similar individuals who differ only by race, ethnicity, gender, or other personal characteristics

Gender Discrimination of Taiwan



1. There is a (narrowing) earnings gap between female and male workers in Taiwan.
2. "什麼都漲，就是薪水不漲?"
More true from men...

	Male	Female	Diff.
2006	\$ 704,614	\$ 497,039	41%
2001	694,475	472,150	47%

Source: 民國95/90年家庭收支調查

Measuring Labor-Market Discrimination

- Median earnings of full-time U.S. workers, 2007:
 - White males earn 21% more than white females.
 - White males earn 24% more than black males.
- Taken at face value, these differences look like evidence that employers discriminate.
- But there are many possible explanations for wage differences besides discrimination; the data above do not control for differences in other factors that affect wages.

Measuring Labor-Market Discrimination

Differences in human capital among groups:

- white males 75% more likely to have college degree than black males
- white males 11% more likely to have graduate degree than white females
- women have less on-the-job experience than men
- public schools in many predominantly black areas are of lower quality (e.g., funding, class sizes)

There may well be discrimination in access to education, but this problem occurs long before workers enter the labor force.

Measuring Labor-Market Discrimination

Recent study by Bertrand and Mullainathan finds evidence of labor-market discrimination:

- 5000 fake résumés sent in response to help-wanted ads.
- Half had names more common among blacks, like Lakisha Washington or Jamal Jones. The other half had names common among whites, like Emily Walsh or Greg Baker. Otherwise, the résumés were the same.
- The white names received 50% more calls from interested employers than the black names.

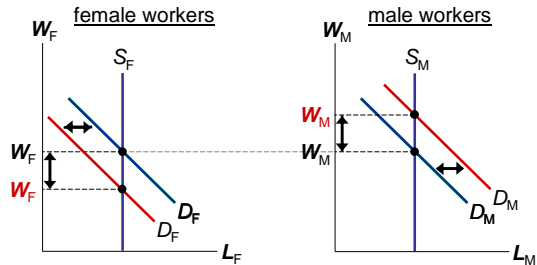
Discrimination by Employers

- Competitive markets provide a natural remedy for employer discrimination:

The profit motive.

Discrimination by Employers

Suppose that firms with high profits hire only whites. Firms with lower profits hire only non-whites. This results in a wage differential, which attracts a lot of other, non-discriminating firms.



Discrimination by Consumers

- Discrimination by consumers may result in discriminatory wage differentials.
 - Suppose firms care only about maximizing profits, but customers prefer being served by whites.
 - Then firms have an incentive to hire white workers, even if non-whites are willing to work for lower wages.

Discrimination by Governments

- Some government policies mandate discriminatory practices.
 - apartheid in South Africa before 1994
 - early 20th century U.S. laws requiring segregation in buses and streetcars
- Such policies prevent the market from correcting discriminatory wage differentials.

CONCLUSION

- In competitive markets, workers are paid a wage that equals the value of their marginal products.
- Many factors affect the value of marginal products and equilibrium wages.
- The profit motive can correct discrimination by employers, but not discrimination by customers or discriminatory policies of governments.
- Even without discrimination, the distribution of income may not be equitable or desirable – a topic we explore in the following chapter.

CHAPTER SUMMARY

- Other things equal, wage differences compensate workers for job attributes: The harder or less pleasant a job, the more a worker is compensated.
- Workers with more human capital are more productive and command higher wages than workers with less human capital.
- Workers with college degrees may get better job offers because the degree signals high natural ability to employers.

CHAPTER SUMMARY

- Wages also may differ with natural ability, effort, and chance.
- Wages are sometimes pushed above their equilibrium levels, due to minimum wage laws, the market power of labor unions, and efficiency wages.
- Some differences in earnings are due to discrimination on the basis of race or other characteristics. Measuring the amount of discrimination is difficult, though.

CHAPTER SUMMARY

- The profit motive tends to limit the impact of employer discrimination on wages.
- Discrimination by consumers or governments may lead to persisting wage differentials.

Earning and Discrimination

- Benchmark (Ch.18): $W=VMPL$
- Other reasons for wage differentials:
 - Job Characteristics: Difficulty, Risk, Superstar
 - Personal Traits: Ability, Effort, Chance, etc.
 - Education: Human Capital vs. Signaling
- Discrimination (and possible cures)
- Homework: Mankiw, Ch.19, pp. 429-430, Problems 2, 6, 7, 8, 10