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Neoclassical economic theory proposes that employment discrimination is inefficient. An employer who chooses employees on the basis of some trait, such as skin color, that is unrelated to productivity will be less successful than competitors who hire solely on the basis of productivity characteristics. Eventually, employers with a “taste for discrimination,” as economist Gary Becker put it, will fail in the marketplace. Inequalities must therefore be associated with productivity-enhancing human capital attributes such as educational attainment or experience.

A corollary to this argument is that affirmative action and other initiatives to address labor-market discrimination are at best unnecessary and at worst counterproductive. The article summarized below challenges this orthodox conclusion, points to extensive evidence of discrimination, and argues that “neoclassical economics cannot be manipulated to produce a convincing story of why groups or individuals who differ ascriptively but who share similar productivity-linked attributes experience differential treatment in markets over time.” [807].

STATISTICAL ANALYSIS OF DISCRIMINATION

Basic evidence of labor market discrimination comes from two types of indirect statistical tests applied to labor market outcomes (i.e., the distribution of wages). The first - a race coefficients approach - uses regression analysis with a dummy variable for race while controlling for human capital variables. A negative, statistically significant coefficient on the race variable is evidence for discrimination, that is, inequality unexplained by standard human capital factors. Using this method, in a 1997 study, Peter Gottschalk found that being black reduced earnings by 11.5% in 1980 and 11.9% in 1990.

The second indirect statistical test is the “Blinder-Oaxaca decomposition,” which distinguishes between two components of inequality. Outcomes for different demographic groups may vary because of average differences in relevant characteristics, or because of different returns to average characteristics; the latter is interpreted as a sign of discrimination. The author and colleagues analyzed 1980 and 1990 census data, dividing the U.S. population into 50 racial/ethnic groups. (Note: this study analyzed men and women separately, examining inequality within each gender. It did not compare women to men.)

The decomposition “found no systematic evidence of in-market discrimination on the basis of race or ethnicity among women.” [809] Among men, some groups (those of Cuban, Mexican, Puerto Rican and Native American ancestry) had losses compared to average American men stemming both from human capital differences and from discrimination. The human capital deficits accounted for a greater part of the overall difference, but for most of these groups, the gap due to discrimination actually grew between 1980 and 1990.

Black and Vietnamese men also had gaps due both to differences in human capital and returns to human capital, but here differential returns had the greater weight. Both in 1980 and 1990 black men lost 10% compared to the overall average due to productivity characteristics (e.g., lower education) and 15% due to discriminatory returns to those characteristics. In 1990 Chinese, Filipino, Japanese and Korean men had better than average returns to their characteristics, for men of Indian ancestry better than average characteristics were offset by discrimination. “Virtually all of the white male ethnic groups experienced advantageous treatment of their characteristics (or racial nepotism).” [809]

COGNITIVE SKILLS AND CULTURE

In the face of this evidence orthodox economists claim that there must be unobserved characteristics related to productivity and correlated with race\ethnicity. Two candidates are cognitive skills and culture. To evaluate cognitive skills, researchers examined results of the Armed Forces Qualifying Test (AFQT) given to 1980 respondents in the National Longitudinal Survey of Youth (NLSY). For both men and women, AFQT scores explained most of the black-white wage gap, and the Hispanic-non-Hispanic white gap.

This appears to support the human capital argument. However the AFQT is problematic and several researchers have explored its implications further. The AFQT is not a test of general intelligence. Rather, AFQT scores can be “treated as outcomes of a structural process generated by the influences of family background, school quality, and psychological motivation....” [810] When a test that *was* intended to measure general intelligence was included in a wage regression, the effect of race remained negative and statistically significant. Some researchers found a fundamental bias in the AFQT itself which yielded different scores for blacks and whites when variables in the NLSY like family background, schooling and motivation were treated as determinants of AFQT results. Psychological variables from the NLSY suggest that blacks are more motivated than whites on average, an unobserved productivity factor that should improve outcomes for blacks.

It is sometimes claimed that the returns to cognitive skills have risen over time, so that the human capital cap now explains a greater income gap than in the past. It may be that returns to cognitive skills have risen, but this does not eliminate the evidence of discrimination. One influential study that found rising returns to math, reading and vocabulary skills in two longitudinal data sets also found a negative and statistically significant effect from race that worsened for 1980 black high school graduates tested in 1986 compared to 1972 graduates tested in 1978.

Two different decompositions performed by the author analyzed the effect of culture. One looked at blacks from different backgrounds: West Indian, Hispanic, European, and other blacks - primarily descendents of U.S. slaves. The other compared black and white Hispanics. Most black women had less-than-average human capital, but slightly better than average returns to their human capital. Black Hispanic women earned more than white women because they had more human capital, but the payoff to their human capital was less than that for all American women. For white Hispanic women the payoff was higher given their human capital than that for all women.. For men, results of both analyses clearly showed that discrimination on the basis of color outweighed the effects of culture.

While not specifically examining the unobserved human capital thesis, a number of other studies have examined the effect of skin shade (in India, Japan, the U.S., the Caribbean and among Chicanos) on socio-economic outcomes and found that darker skin was associated with poorer outcomes. One study also analyzed the level of African ancestry (as determined by genetic tests, not appearance) and “found no correlation between degree of African ancestry and performance on IQ tests, but they did find a correlation between skin shade and IQ scores. This suggests that it is the social perception and treatment of darker-skinned persons that dictates their weaker social outcomes, not their biological inheritance.” [821]

AUDIT STUDIES

Audit studies provide a more direct test of discrimination, and have been used with employers, realtors and lenders. In audit studies black and white applicants are carefully matched, either by training actors to present a similar demeanor and/or constructing similar documentation of qualifications. An Urban Institute audit of employment in three U.S. cities found that

black males are three times as likely to be rejected for jobs as white males and Hispanic white males also are three times as likely to be rejected for jobs as non-Hispanic white males.... Another study... found evidence of discrimination against blacks at all stages of the employment process: lower likelihood of invitation to interview, considerably lower likelihood of receipt of job offer, lower wage offers when job offers were made, and less consideration for unadvertised positions at higher levels than jobs originally advertised. The same study also detected systematic evidence of discrimination against black women when compared with white women, unlike the typical finding in the indirect statistical tests of the types described above [815]

DISCRIMINATION AND ITS EFFECTS OVER TIME

The Gottschalk study mentioned above shows a negative effect on earnings from being black in each of year from 1964 to 1995. But in the years immediately following the 1964 Civil Rights Act earnings gap narrowed sharply , from -.426 in 1964 to -.126 in 1976. Then it stabilized, actually increasing slightly to -.140 in 1995. This pattern of falling discrimination in the 1970s with little change since then was also evident in a decomposition of census microdata performed by the author and colleagues using an index of occupational prestige as the outcome variable.

Inequalities among racial\ethnic groups (whether from human capital differences or discrimination) persist over long periods of time. A two stage statistical analysis of occupational status among almost 40 racial and ethnic groups of men concludes that disparities found in census data from 1880, 1900, and 1910 continue to influence occupational status reported in census data from 1980 and 1990.

When policies such as affirmative action have been proposed, opponents often claim that such measures cannot achieve a raceless society. “But is a raceless society one in which race merely is omitted from official or legal categories or one in which race is not a factor in influencing life chances? ... If we are collectively to agree to ignore race, then we should be in a world where race truly does not matter.” [822]