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# Commentary

**Title:**

*"Why Competitive Markets  
Discourage Discrimination"*

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In a previous Commentary article, I proposed the idea that the wage gap between men and women was due to benign factors rather than to discrimination against women. The thrust of the article was that there are many wage differentials in our society that we know are fair and just, and that there is good evidence that the difference between men's wages and women's wages are as well. However, it was also conceded that the pay gap *could* be due to discrimination, but that the "charges" are not proven. In the present article I make the further argument that discrimination, whether against women, minorities, the aged, or others, is not only unlikely in competitive markets, but is *actively* combatted by them. This will even be true when there are no anti-discrimination laws in labor markets.

Before we try to prove our thesis, we need to define some terms. Labor market discrimination means treating equally productive people differently in employment opportunities, pay, promotions, and other job related factors. Discrimination *does not* exist when people of *different* productivity are treated differently in those same dimensions. For instance, no one thinks it wrong to pay male CPA's more than male accounting clerks or male doctors more than male nurses or male electrical engineers more than male electricians. Discrimination in the form of sexism, racism, or ageism is not the relevant factor in these examples of pay differentials. Normally we think of discrimination as a form of irrational unjustifiable prejudice against a person, while the examples of pay differentials just given are clearly rational and justifiable, since they are based on productivity differences.

So how do we conclude that the pay differential in a competitive capitalist economy between men and women, whites and minorities, older workers and younger workers, and others, is justifiably based on productivity differences rather than unjustifiable prejudice?<sup>1</sup> To reach this conclusion, it helps to consider the following hypothetical scenario in a market with no anti-discrimination laws.

Assume that there are dozens of brick laying contractors in the Atlanta area bidding on jobs. In the labor market there are hundreds of qualified bricklayers, some of whom are white, some Hispanic, and some black. Assume that they are all equally skilled and lay an average of 400 bricks per day. Prejudiced (i.e., racist) brick contractors insists on hiring white workers and avoid hiring minority workers, even though they are presumably equally productive. Using ordinary supply and demand analysis we can see that this behavior will lead to a shortage of white bricklayers and a surplus of minority bricklayers. This prejudiced hiring behavior will lead to a non-productivity based wage differential. For the sake of discussion, suppose the differential hiring practices lead to wages that are 25% more for white bricklayers (or, alternatively, 20% less for minority workers). For example, racist contractors are paying \$20 per hour to hire only white workers, while other contractors are able to pay only \$16 per hour to hire minority workers.

For many people these current period observations are the end of the story. However, we need to consider the following question: Is this \$4 wage differential between equally productive white and minority bricklayers stable in the long term? Consider the difference in cost and profit of the discriminatory firms that hire white workers at \$20 per hour versus the non-discriminatory firms that hire minority workers at \$16 per hour. If the average firm employs 20 bricklayers for 1,800 hours per year, then a discriminating contractor will have labor costs \$144,000 higher (leading to profits that are \$144,000 lower) than his non-discriminating competitors.

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<sup>1</sup> Not all pay differentials are in favor of white males. In the U.S., Asians earn more than whites on average. This fact further militates against the proposition that all wage differentials are due to discrimination. See: <https://www.bls.gov/opub/ted/2018/asian-women-and-men-earned-more-than-their-white-black-and-hispanic-counterparts-in-2017.htm>

The purpose of this hypothetical scenario is to illustrate that discriminatory hiring practices based on irrational prejudices – such as pure racism – are costly to the discriminator. Those contractors who are less racist or non-racist get more building contracts by underbidding their more racist brethren because they have lower labor costs. In the long term, we would expect to see the racist firms fall by the wayside, and the wage differential between white and minority bricklayers evaporate. After all, if the remaining firms are less racist they would see an advantage in hiring more minority workers at a lower cost, and refraining from hiring the higher cost white workers. Over time, this would lead to a surplus of the overpriced white workers and a shortage of the equally skilled but lower paid minority workers. As long as there was a wage differential between them there would be downward market pressure on white wages and upward pressure on minority wages, leading to equal wages in the long term.

Many people may not believe that a profit differential of \$144,000 will generate this kind of change. But what if the profit differential between prejudiced and non-prejudiced firms were larger? Our scenario was based on a firm of only 20 workers. What would the profit differential be for a firm hiring a thousand workers? If we assume that the male/female wage gap of 20% applies to equally productive workers (which the current prevailing criticism of the wage gap presumes), then a firm hiring 1,000 workers could gain \$9,150,000 in profit<sup>2</sup> by laying off their male workforce and replacing them with female workers at existing wage rates.<sup>3</sup> As of 2011, there were over 11,000 firms in the U.S. with more than 1,000 employees.<sup>4</sup> What would the differential be for the truly large firm? CurtisMorley.com finds that there are 975 firms in the U.S. employing 10,000 or more employees.<sup>5</sup> If a firm hiring 10,000 workers switched from an all-male workforce to an all-female workforce, they would generate an extra profit of \$91,500,000. For a truly large firm the size of Walmart, the profit differential would be staggering. If a firm of this size, employing 1.5 million workers, were to switch from hiring all males to all females at current average wage differentials, the increased profit would be \$13.7 Billion.

If we applied the analysis of profit differential from above to the Black Male/White Male differential of 30% we would generate an even larger profit by firing white males and hiring black ones.<sup>6</sup> For the firm employing 1,000 workers the gain would be \$14 million, for a firm employing 10,000 workers the gain would be \$140 million, and for the firm hiring a million workers the gain in profit would be \$14 billion.<sup>7</sup>

Is it reasonable to believe that the owners of firms would pass up profits of this magnitude if they could hire equally qualified women and minorities at the current wage differentials? Anecdotal evidence leads to the opposite conclusion. President Trump roundly criticized the decision of Carrier Corporation during the last election for their decision to move their factory to

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<sup>2</sup> Author's calculation based on weekly average wage differential of \$183 for 50 weeks per year. For further details see: <https://www.bls.gov/news.release/wkyeng.t01.htm>.

<sup>3</sup> This scenario is not farfetched. See the following example of U.S. workers getting laid off and being forced to train their replacements: <https://www.dailymail.co.uk/news/article-4037392/Disney-fired-250-American-workers...>, <https://www.foxnews.com/politics/senators-seek-probe-of-claims-us-workers-fired-forced-to-train-foreign-replacements>, and <https://protectusworkers.com/thousands-of-att-workers-fired-forced-to-train-their-foreign-visa-holders/>

<sup>4</sup> <https://curtismorley.com/2011/02/02/how-many-companies-in-the-u-s-have-over-1000-employees/>.

<sup>5</sup> *Ibid.*

<sup>6</sup> The Bureau of Labor Statistics reports an average of \$18 per hour for black males and \$25 per hour for white males, for a differential of \$7 per hour. <https://www.bls.gov/opub/mlr/2017/beyond-bls/the-unexplainable-growing-black-white-wage-gap.htm>.

<sup>7</sup> Author's calculations based on \$7 wage differential for a full-time, full-year job of 40 hours per week and 50 weeks per year.

Mexico. This is an example of “firing” their white workforce to “hire” a Hispanic one. U.S. firms have been relocating their factories and/or outsourcing their manufacturing overseas to gain the profits illustrated in our examples above. If the executives who run these companies are racists in their hearts, they sure seem to be overcoming it when it comes to their workforces!

If racism, sexism, and ageism are not the main cause of wage differentials, what is? As I pointed out at the beginning of this article, wage differentials can often be legitimately explained by differences in productivity. We all accept that a CPA earns more than an accounting clerk due to the higher skill and productivity. Economists have found many factors that impact a person’s productivity, including differentials in education, years of experience, language skills, unionization rates, job travel, overtime worked, and college major chosen, among many others.<sup>8</sup>

Once these legitimate differentials have been factored in, the difference in wages between the sexes or races mostly disappears. The good news is that Free-Market Capitalism does not foster inequality, but rather actively combats it. This is not due to the superior moral qualities of businesspeople, but rather to the competitive pressures brought to bear on them in the labor market. Firms that discriminate on irrational, non-productivity based grounds find their labor costs rising compared to their non-discriminating competitors, and therefore suffer a reduction in profits. If we truly want to reduce wage gaps in our society we need to find ways to reduce the productivity gap.

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<sup>8</sup> In addition to productivity based differentials, we can add Compensating Differentials in pay. These are differentials paid for accepting onerous or dangerous negative job characteristics. Examples include night shift premiums for hospital based nurses, or higher pay for long-distance truckers who are gone from home a great deal, etc.