

Chapter 19: Earnings and Discrimination
Principles of Economics, 8th Edition
N. Gregory Mankiw
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1. *This is an interesting chapter because it gives you a different perspective on a controversial issue.*

2. Some Determinants of Equilibrium Wages
 - a. Def: Compensating differentials are a difference in wages that arises to offset the non-monetary characteristics of different jobs. P. 384
 - b. Def: Human capital is the accumulation of investments in people, such as education and on the job training. P. 385
 - c. **Case Study: The Increasing Value of Skills, P. 385**
 - i. Alternative explanations:
 - (1) international trade or
 - (2) technological trade.
 - ii. The ratio of college graduate earnings to high school graduate has been increasing over the past decades.
 - (1) *This ratio understates the difference as better paid workers usually have better fringe benefit packages.*
 - iii. *Is this what you read in the newspapers--where bad news sells?*
 - iv. **Table 1: Average Annual Earnings by Educational Attainment. P. 386**
 - v. **Ask the Experts: Inequality and Skills, p. 386**
 - (1) **86% agree**
 - vi. **In the News: Schooling as a Public Investment, p. 387.**
 - vii. Ability, effort, and change
 - (1) Only half of wages is explained by observable variables.
 - d. **Case Study: The Benefits of Beauty, P. 388**
 - e. An Alternative View Of Education: Signaling
 - i. While signaling is important, it also introduces us to the idea that the acquisition of information is a costly process, so rational people pursue additional information only so long as they expect the benefits to exceed the costs.
 - ii. Everyone--including you--can spend a lot of time and money to acquire information about a particular person, but you can economize on the acquisition of information by relying on the perceived mean values for a group: Harvard vs. Western New Mexico, Men vs. Woman, Blacks vs. Asians, etc.
 - iii. Why people have incentives to challenge erroneous stereotypes is discussed below under discrimination by employers.
 - f. The superstar phenomenon
 - a. Above-Equilibrium Wages: Minimum Wage Laws, Unions, and Efficient Wages
 - i. A union is a worker association that bargains with employers over wages and working conditions. P. 391

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- ii. A strike is the organized withdrawal of labor from a firm by a union.
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 - iii. The efficient wage is an above equilibrium wage paid by firm to increase worker productivity. P. 391
3. The Economics of Discrimination
- a. Def: Discrimination is the offering of different opportunities to similar individuals who differ only by race, ethnic group, sex, age, or other personal characteristics. P. 391.
 - b. Measuring labor market discrimination
 - i. While discrimination can affect wages, much of wages differentials is based on differences in human capital and compensating wage differentials.
 - ii. **Table 2: Median Annual Earnings by Race and Sex, P. 392.**
 - iii. **Case Study: Is Emily more Employable than Lakisha?, P. 393.**
 - c. Discrimination by employers
 - i. If wages do not reflect productivity, employers have incentives to compete for “underpaid” workers, reducing any effects of discrimination.
 - (1) However, there are profits to be made by challenging the stereotypes, if they are wrong.
 - (2) If the common perception is that female accountants are less productive than males and, therefore, are paid less, then employers who know that is not true have incentives to hire female accountants--at lower wages--therefore, producing higher profits for the company.
The higher profits will demonstrate the higher productivity of female accountants, eventually increasing the demand for them and, therefore, their earnings.
 - ii. When there is no profit motive--government, for example--there is a lower cost to exercising one’s preferences, so discrimination is less costly and, therefore, more likely to occur.
 - iii. **Case Study: Segregated Streetcars and the Profit Motive, P. 394.**
 - d. Discrimination can be caused by consumers’ preferences and government action.
 - i. If consumers prefer contact with certain types of workers, then that will increase their demand and, potentially, their earnings.
 - (1) Male accountants may earn more than female accountants if customers of accounting firms prefer to deal with men.
 - ii. *Since the political process is based on majority rule--51 percent can determine what everyone does, it does not permit the diversity that*

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would result in markets.

(1) Prior to Brown vs. Board of Education, the south might have had all black schools, all white schools and mixed schools except for laws segregating blacks and whites.

- iii. Competitive markets contain a natural remedy for employer discrimination.
- iv. The entry into the market of firms that care only about profit tends to eliminate discriminatory wage differentials.
- v. These wage differentials persist in competitive markets only when customers are willing to pay to maintain the discriminatory practice or when the government mandates it.
- vi. **Case Study: Discrimination in Sports, P. 395.**

Conclusion

Summary