Current Labor Market Discrimination and Affirmative Action

Senior Integration Paper in Economics

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I. Introduction

Affirmative action has reigned as one of the most controversial issues of our time. From scholars to politicians and employers to employees, people are divided concerning the need for and implementation of policies, plans and programs that seek to reduce minority discrimination. While affirmative action is a broad term for programs concerning racial and gender equity, this paper will be addressing the specific effects of affirmative action in the black/white labor market setting.

Affirmative action policies began in the 1960s and initially intended to help solve the problem of discrimination among minorities and women. In 1969 the Philadelphia Plan was enacted. It instituted the first government affirmative action program and demanded more minority hiring in the segregated Philadelphia construction industry. It was quite extensive, to the point of goal and percentage setting. In 1973 the Equal Employment Opportunity Commission (EEOC) stated that all employers must institute result-oriented affirmative action programs. Yet the influence and effectiveness of affirmative action was greatly diminished by the lack of funding and support the EEOC received from President Ronald Reagan during the 1980s. The problem lay in the fact that the EEOC could no longer effectively keep up-to-date reviews of the hundreds of thousands of businesses covered by affirmative action policies. They could also no longer pursue affirmative action cases to the full extent that they had before President Reagan. Additionally, President Reagan appointed two anti-affirmative action Supreme Court justices. As a result, affirmative action policies no longer held the strong backing of the Supreme Court and affirmative action as a whole faded in its ability to be a solid, effectual policy.
In 1995 President Bill Clinton promised support of affirmative action urging, “Mend it, don’t end it.” This promise turned out to be quite empty, since his review of affirmative action in federal programs turned out to be quite limited and gathered little interest. Affirmative action in education felt the effects quite strongly. The U.S. Court of Appeals for the Fifth Circuit struck down affirmative action in Texas schools in 1996 and in 1999 the Center for Individual Rights in Washington D.C. filed lawsuits against the University of Michigan and University of Washington law schools for their affirmative action admissions policies (Eisaguirre 1999).1

Many authors argue for the need to bring back affirmative action (Lawrence 1997, Shipler 1997, Wicker 1996); however, the key to recognizing a need for affirmative action in employment is dependent upon the evidence of current labor market discrimination. It has been shown that there is a definite wage gap between minorities and whites (Darity, Guilkey and Winfrey, 1996); however, there is much debate as to what that wage gap is attributable to. A number of studies have found evidence that current labor market discrimination may be the cause of the wage gap (Darity and Mason 1998, Gottschalk 1997). At the same time, Nobel Laureate James Heckman (1998) questions several of their methodologies and finds the black/white wage gap to be attributable to pre-labor market factors. Neal and Johnson (1996) also attribute the majority of this gap to pre-labor market forces. It is this lack of consensus on the topic that leads to much of the debate over whether or not affirmative action policies are needed in employment.

1 See appendix for complete time line of events concerning affirmative action for minorities in employment.
Even if it is determined that there is discrimination, one must then determine whether or not affirmative action is an effective policy at resolving the effects of discrimination and also what long term benefits or negative consequences affirmative action may have for blacks. Once again, studies are inconclusive. Leonard (1984, 1990, and 1996) finds an increase in the growth of black employment in the labor market attributable to affirmative action policies from 1974-1980; however, this is only in firms that are bidding for government contracts. He also finds that there is a rise in wage disparities between 1980 and 1990. Although he attributes this to President Reagan’s decreasing support of affirmative action, there are actually a number of other confounding factors outside the labor market which play a key role in forming wage disparities.

The effectiveness of affirmative action policies is combated by theoretical research by Coate and Loury (1993), who find that affirmative action can create both a “good” and a “bad” equilibrium. In the “good” equilibrium employers form homogenous views of all workers, while in the “bad” equilibrium negative stereotypes are not eliminated, but further reinforced. In response to this “bad” equilibrium, Lundberg and Startz (1983) argue for equal wage scales to encourage blacks to invest in human capital. Coate and Loury propose a solution that includes a wage subsidy for blacks in higher level positions, creating an incentive for human capital accumulation among blacks and eventually leading to the elimination of negative employer stereotypes.

Aside from the effects of current labor market discrimination, it is also important to take into account other types of labor market related discrimination which have possible negative consequences for black employment. This includes such factors as
discrimination in accessing credit through small business loans (Blanchflower, Levine and Zimmerman 1998) and the affects of customer discrimination (Holzer and Ihlanfeldt 1998). Heckman (1998) also points out the difficulty of measuring expectations of discrimination. An expectation of discrimination can lead to the disincentive to apply for employment, small business credit or to get an education in the first place.

How then should policies concerning employment for blacks be shaped? Using a reformed worldview as its guideline for understanding man’s right and responsibility to work, this paper seeks to evaluate the need and effectiveness of affirmative action. First, it will carefully outline the reformed perspective that will be used in assessing affirmative action. It will then take up a careful examination of the research concerning current labor market discrimination. The paper will also examine the evidence on the effectiveness of affirmative action in addressing whatever current labor market discrimination which might still exist.

This paper will evaluate affirmative action and will argue that it is an ineffective solution to the black/white wage gap for a number of reasons: 1) There is little evidence of significant current labor market discrimination. 2) Affirmative action creates a disincentive for blacks to accumulate human capital, thus undermining their ability to develop and use their gifts. 4) Affirmative action may perpetuate bad employer perceptions of blacks’ abilities. 5) There are other means which will cause greater human capital accumulation among blacks and still address the remaining black/white wage gap. There are also other forms of labor market related discrimination – e.g. credit market discrimination – that may need additional corrective measures that neither affirmative action nor human capital accumulation can address.
II. Foundational Commitments

In order to evaluate effectively affirmative action from a Biblical perspective, it is important to know exactly what that perspective entails. This paper will be utilizing a reformed worldview, which is characterized by the aspiration to live by scripture alone as opposed to scripture alongside of tradition (Wolters 1985). Characteristic of this worldview is a belief in God’s plan as expressed in a creation-fall-redemption-consummation framework. The principles found within this framework will then be used to gain a greater understanding of what the role of the state is in upholding these principles and why affirmative action falls short in its objectives.

God created all things and there are certain characteristics about His creation that aid in better understanding the creator. He states in Genesis and in I Timothy 4:4-5 that his creation is good. According to Wolters, “God does not create junk and he does not junk what he has made.” In Genesis 1:27-28 God issues the cultural mandate:

So God created man in His own image; in the image of God He created them; male and female He created them. Then God blessed them, and God said to them, “Be fruitful and multiply; fill the earth and subdue it; have dominion over the fish of the sea, over the birds of the air, and over every living thing that moves on the earth.

In verses 29 and 30 that follow and in Genesis 2:15 God gives man the garden to tend to and take care of and gives him dominion over the animals that they shall be food for him.

And God said, “See, I have given you every herb that yields seed which is on the face of all the earth, and every tree whose fruit yields seed; to you it shall be for food. Also to every beast of the earth, to every bird of the air, and to everything that creeps on the earth, in which there is life, I have given every green herb for food”; and it was so.

Genesis 1:29-30

Genesis 2:15
The Lord God took the man and put him in the Garden to tend and keep it. It is from these verses that important insights into Biblical principles for economics and work may be drawn.

On the basis of the Genesis account, Hay (1989) formulates the following eight basic principles for a Biblical perspective on economic life: 1) Man must use the resources to provide for his existence, but he must not waste or destroy the created order; 2) Every person has a calling to exercise stewardship of resources and talents; 3) Stewardship implies responsibility to determine the disposition of resources. Each person is accountable to God for his stewardship; 4) Man has a right and obligation to work; 5) Work is the means of exercising stewardship. In his work man should have access to resources and control over them; 6) Work is a social activity in which men cooperate as stewards of their individual talents and as joint stewards of resources; 7) Every person has a right to share in God’s resources for mankind for their basic needs of food, clothing and shelter. Their needs are to be met primarily by productive work; 8) Personal stewardship of resources does not imply the right to consume the entire product of those resources. The rich have an obligation to help the poor who cannot provide for themselves by work.

Finally, it is important to realize that creation is not complete. The two types of creation include the initial creation and the creation that God is continuing through man. Because man is a steward of creation, he is a co-creator with God. God through man is a creator of social systems and structures, and the continuing of creation leads to cultural developments, along with which comes differentiation and specialization.
The fall is a result of man’s first sin in Genesis 3:6. The impacts of the fall are cosmic in scope; no thing is left untouched from it (Wolters 1985). In Genesis 3:14-19 one sees the direct multifaceted effects of the fall: the ground is cursed, there is pain in childbirth and work becomes harder. The good creation has been distorted making the cultural task immensely more difficult with innumerable conflicts (Meeter 1967). One such conflict is seen in discrimination. Discrimination is a distortion of God’s good mandate for work. Other distortions such as slavery have also emerged from discrimination. At the same time, one must also realize that solutions for discrimination, such as affirmative action, are also affected by the fall. Economic systems cannot fully ensure just outcomes; however, they must still strive for just outcomes. It is also important to note, though, that the cultural mandate is not negated. Sin has not made man’s cultural tasks superfluous or unnecessary (Meeter 1967). In Genesis 9:1 the cultural mandate is reinstated with Noah after the fall.

Hay’s principles for economic life provide a good framework for understanding the falleness of work. Discrimination itself is a result of the fall, and it is wrong in that it violates the principle of the right to work. It often keeps people from obtaining work and it can also limit people from advancing to better jobs thus restricting their means of exercising stewardship. This same discrimination also keeps people from working as joint stewards. Discrimination restricts the social aspect of work. Because the access to work is being limited, so too is the access to resources being restrained. Work is the means by which people provide for their needs such as food, clothing and shelter. When one is denied access to work or that work is limited, the ability to obtain resources through that work is also hindered.
Yet there is also good news concerning the fall. Creation and the fall are two distinct events. God curbs sin through “common grace” and because the good creation precedes the fall, evil cannot be blamed on the creation (Wolters 1967). God continues to uphold and sustain creation. This is seen in passages such as Colossians 1:16-17, Hebrews 1:2-3 and Psalm 24:1, where God’s people are assured that He has not abandoned them.

Just as the effects of the fall are cosmic in scope, so too is the redemption. The redemption and restoration are not limited to any small part of God’s creation. It is in this redemption that everything that is fallen will be renewed. This includes fallen structures and social systems as well. As we try to fix fallen systems ourselves, we fall short. Still, these systems that were designed to fix what is fallen, such as fixing discrimination, will no longer be needed when all is healed. Colossians 1:20 states that God reconciles all things to himself though Christ. Jesus began the work of redemption, but it is not yet complete. The Kingdom is not here yet as seen in Revelation 21:1-4 and the final consummation is still to come.

III. The Role of the State

A crucial feature of understanding how affirmative action should be implemented lies in understanding the role of the state. The state has a responsibility to make sure that people are able to participate freely in work and through that work provide for their needs. There is a need to uphold justice. As stated by Brunner (Zylstra 1982),

The Christian conception of justice is…determined by the conception of God’s order of creation. What corresponds to the Creator’s ordinance is just to that ordinance which bestows on every creature, with its being, the law of its being and its relationships to other creatures. The “primal
order” to which every one refers in using the words “just” or “unjust,”
the “due” which is rendered to each man, is the order of creation, which
is the will of the Creator made manifest.

The responsibility to uphold this justice lies within the state. Zylstra (1982)
states, “The norm of Justice requires a social order in which people can express
themselves as God’s imagers.” People are made in the image of God as seen already in
Genesis, and they must be able to fulfill this role. There must be social space and
freedom for human service and for “the human self whose calling lies in love of God and
love of neighbor.” It is the state that has the responsibility of administration and
dispensation of justice. This is seen in Romans chapter 13:1-7, where Paul explains the
authority of the state. As he states in Romans 13:1, “Let every soul be subject to the
governing authorities. For there is no authority except from God, and the authorities that
exist are appointed by God.” It is important that the state creates room for societal
growth; different “spheres” of society need room in order to develop, and the state’s job is
to prevent conflict amongst these spheres.

Similarly, Mott (1996) states, “Authority, corporate responsibility and collective
decision making are essential to every form of human life.” Again, there must be some
organization that is responsible for enabling society to function; that organization is the
state. The government as an institution now required because of the fall; it is needed to
ensure that the community can function as God intended. The state must be able to step
in when there is not mutual care within the community. The state must be able to
regather the community. According to Mott, justice is restoration to community, and it is
the community’s responsibility to make weaker members strong again and restore them
to full participation in the community. As is stated in the book of Leviticus, and specifically in Leviticus 25:35, people must be able to live beside one another in the land.

It is part of God’s creation for man to be in community, and it is the state’s responsibility to uphold that community. The question arises: “How then is the state to uphold justice?” The method under evaluation in this paper is affirmative action. Affirmative action seeks to correct past and present injustices, specifically discrimination, by mandating equal opportunities for employment. This includes not only public employment settings, but private ones as well. The state is to step in wherever justice is not being upheld and wherever the needed societal space is shrinking. Affirmative action seeks to restore members of the community to their full rights and standing. It works to uphold the community through employment. Affirmative action aims to elevate the oppressed so that they may work alongside fellow community members.

At the same time affirmative action may have negative effects for the community. Rather than elevating the oppressed, it may have the opposite effects since it can lower standards for the oppressed. It may also cause rifts in the community as community members become resentful of the actions of the state. Nonetheless, it is the people’s responsibility to submit to the state which was appointed by God in order to maintain his community. Instead of bringing people into community, affirmative action may segregate minorities into certain fields and sectors. While affirmative action may have the right intentions in mind, if it is not able to follow through with these intentions, it is not an effective policy in regards to upholding justice.
VI. Literature Review

In order to assess the need and effectiveness of affirmative action, one must first determine whether or not there is current labor market discrimination. Evidence of current labor market discrimination is quite a controversial topic, and what follows is an assessment of the literature covering labor market discrimination and minorities.

In the 1998 *Journal of Economic Perspectives* symposium on discrimination, Darity and Mason (1998) provide a comprehensive look at studies that have measured current labor market discrimination. They cite various different studies which, according to Darity and Mason, attribute an average of 12-15% of the black/white wage gap to current labor market discrimination. A closer look at these studies will aid in understanding these author’s conclusions and potential faults in their methodologies.

Gottschalk (1997), who is cited by Darity and Mason, finds a 15% wage inequality among blacks; however, his human capital controls only include education levels and levels of experience. There are no controls for firm type or location, education quality, or as Heckman (1998) later points out, some of the “personnel” variables that are important to firms in their hiring decisions; many of these personnel variables are not available to economists studying the issue. Gottschalk also acknowledges the fact that studies on discrimination are still unclear in their findings. He does not directly link the wage gap to current labor market discrimination as Darity and Mason do in their summary.

Using U.S. Census data for 1980 and 1990, Darity, Guilkey and Winfrey (1996) find that a significant portion of the wage gap between blacks and whites cannot be explained by variables used to control for productivity differences. In studying 1980 and
1990 census data, Darity, Guilkey and Winfrey do not state what size gap they do find; however, it is listed in appendix tables not included with their published paper. They attribute the wage gap to human capital through use of a Blinder-Oaxaca decomposition model. They substitute the average wage characteristics for a group into a wage equation for the U.S. as a whole and compare this to the wage that the group is actually getting paid. The difference then represents the positive or negative returns to these characteristics. The rest of the wage gap is then assumed to be due to current labor market discrimination. The variables they use to measure these characteristics include work experience (current age minus last year of schooling), English fluency, whether or not one has a disability, whether or not one was born in the U.S., level of assimilation in to the U.S., location and job sector. Again, as will be shown later through the work of Heckman (1998), this still does not represent a complete measurement of human capital.

Becker (1957) published the first theoretical work on labor market discrimination, where he presents a model in which labor market discrimination is dependent upon the absence of competitive labor and product markets. As summed up by Kimenyi (1995), continuance of discrimination depends upon the number of non-discriminatory firms in the market. If there are enough non-discriminatory firms, discriminatory firms will not be able to indulge their discriminatory tastes because discrimination is not profit-maximizing. Firms that do not discriminate have an advantage over firms which do discriminate. Discrimination will end as long as there are competitive labor markets. However, there is reason to believe that labor and product markets do not work perfectly

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2 It is assumed here that the 12-15% wage gap figure quoted by Darity and Mason (1998) includes the figures from the Darity, Guilkey and Winfrey (1996) paper as Darity is likely to have easy access to his 1996 results.

3 In their study, the return on these characteristics for blacks is negative.
and as a result, they may not be able to drive out discrimination as suggested by Becker. As Heckman (1998) interprets the model, it may not be the Becker model that is at fault, but the effects of past discrimination that are taking decades to work themselves out. As will be seen below, he focuses on the fact that current labor markets are not generating large economic disparities, but wage differences arise due to past discrimination effects.

The 1998 *Journal of Economic Perspectives* symposium in which the Darity and Mason article appears also contains a critique of Darity and Mason by Nobel Laureate James Heckman. His effective evaluation reveals Darity and Mason’s shortcomings and misinterpretations and aids in explaining the lack of decisive evidence on current labor market discrimination. One of the most important aspects Heckman criticizes is the data sets used by Darity and Mason and the studies they cite. The 1980 and 1990 Census and Current Population Survey (CPS) data are some of the most widely used sets, and they are also some of the most incomplete. An economist does not always have access to the relevant data used by employers in their hiring and promotion decisions. The productivity characteristics used by personnel departments are significantly more detailed than the measures of human capital used by economists. While regressions based on Census/CPS data can typically explain 20-30% of the variation in black/white wages, regressions based on personnel data can explain 60-80% of the black/white wage gap, still leaving 20-40% of the wage gap still unexplained. As Heckman states, “It is more than idle speculation to claim that the standard data sets used to estimate discrimination omit many relevant characteristics actually used by firms in their hiring and promotion decisions.”
An example of the type of discrepancies that may arise from Census/CPS data and personnel measures lies in measuring high school credentials. The Census/CPS data equates General Equivalence Degree (GED) recipients with high school graduates. However, black high school certificate holders are much more likely to have a GED than a white high school certificate holder (Cameron and Heckman, 1993). In the data used by Darity and Mason, 14% of black high school certificate holders held a GED compared to only 8% of whites. Given that Cameron and Heckman find that GED recipients’ earnings are equivalent to those of a high school dropout, Heckman finds it plausible to assume that black high school certificate recipients will earn less than whites recipients. The literature cited by Darity and Mason does not recognize this issue. Moreover, the GED factor alone can explain 1-2% of the 12-15% wage gap attributed to current labor market discrimination by Darity and Mason.

Neal and Johnson (1996) look to the Armed Forces Qualification Test (AFQT) as a way to explain the differences in the black/white wage gap that is found by Darity and Mason. It serves as a substitute for the personnel data that Heckman recommends, but that economists do not have access to. They first recognize that many of the standard controls used to measure labor market productivity may be: 1) affected by other forms of discrimination and 2) imprecise measures of worker skill. Furthermore, they find that the AFQT to be an effective explanatory tool for the wage gap. Because the test is administered before market entry, it is less likely to be contaminated by worker choices or labor market discrimination. Neal and Johnson ran two wage regressions. The first regression considered wage as a function of race and age and the second regression added AFQT as an independent variable. The AFQT was able to explain approximately 75% of
the original wage gap. The wage gap between black and white incomes went from 24% to 7%. This leaves 25% of the total wage gap unexplained, which is consistent with the 20-40% figure stated earlier by Heckman. However, Neal and Johnson do admit the need for further research using the AFQT as far as time length is concerned. Because of the limited span in birth years in their data set, they are unable to measure the wage differences beyond workers in their late twenties.

Both Heckman and Neal and Johnson recognize the need for increased human capital among blacks to solve the problem of the wage gap. Pre-labor market factors, such as higher quality education including better family and pre-school learning environments, improved quality in the early years of schooling and overall more positive family and school environments, must be targeted. The factors that affect the acquiring of skills are most influential in the early years of growth. Heckman and Neal and Johnson do not have a solution for the problem of expectation of discrimination. If children expect discrimination or see their parents experiencing pre-labor market discrimination\(^5\) then, they are not likely to have the motivation to invest in human capital skills earlier on.

The most recent findings concerning current labor market discrimination are still quite inconclusive and one cannot entirely rule out the possibility of current labor market discrimination. Even Neal and Johnson still find a 7% wage gap between blacks and whites that cannot be explained. One answer to solving this remaining wage gap has been affirmative action. The following section will evaluate the effectiveness of

\(^4\) The AFQT test is administered as teenagers are leaving high school.
\(^5\) This may include pre-labor market discrimination such as in the housing market or in education. It could also include past labor market discrimination that is no longer present when the children enter the labor market.
affirmative action at meeting this goal and what implications this performance has for future policy.

Jonathan Leonard has conducted extensive studies measuring the results of affirmative action policies. Leonard (1984) studies 68,000 firms with more than 16 million employees from 1974-1980. Over this six year period, Leonard finds a black male employment growth rate that is 3.8% faster among contractors than non-contractors. When he compares contractors that have undergone reviews by the Office of Contract Compliance (OFCC) to non-contractors, the growth rate for black male employment is 12% higher. It may appear at first sight that affirmative action is increasing black male employment, but one must realize that this is only among contracted firms. That is, firms that are bidding for government contracts are necessarily abiding by government policies so that they may win the government bid. The contracted firms are operating in their own self interest; it may be more beneficial for them to do whatever the government says in order to win the bid than it is to act in a discriminatory manner. Additionally, these firms may be hiring more minorities, but less-skilled minorities. Leonard finds that firms bidding for a government contract are large, growing fast and utilize a large amount of low-skilled workers.

In a later paper, Leonard (1996) measured the average wage gap in 41 industries and 113 cities between 1980 and 1990 and found it to be increasing for blacks. Leonard states that this may be reflective of the lack of emphasis placed on affirmative action during this time. As the funding for affirmative action policies began to fade, so too did the results of affirmative action. However, he is also careful to realize that there is much more that could be affecting these figures than lack of affirmative action emphasis. An
increasing wage gap cannot be directly connected to increasing current labor market discrimination. Other factors such as a decrease in minority education quality or increased discrimination in education may also be at work.

Leonard also points out a number of reasons for impreciseness that are shared by both studies. Such problems as lack of pre-affirmative action data on businesses, changes in demand during the 1980s, and the threat of enforcement as being more effective than actual enforcement all lead to potential bias problems. Furthermore, Leonard recognizes that there is a need overall for continued research concerning the outcomes of affirmative action policies.

In their theoretical study of employer’s negative stereotypes, Coate and Loury (1993) evaluate the effectiveness of affirmative action in a labor market in which there is imperfect information. In order to keep the costliness of worker/job mismatch at a minimum, employers make decisions concerning worker placement based on their group membership. When employers maintain a negative view of minorities, it lowers the minorities’ return on human capital investment. This lowered return then leads minorities to invest less in human capital, so they do end up having weaker qualifications than majority groups. An equilibrium may be created in which the negative stereotypes of the employer are confirmed. This also results in a lower level of qualified minority workers in the group for employers to choose from.

This same equilibrium model can be used to assess whether affirmative action leads to a break down of these stereotypes. Coate and Loury find that under affirmative action, both a “good” and a “bad” equilibrium may emerge. As employers are forced to

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6 During the 1980s the collapse of defense expenditures clearly reduced employment in the largest single group of government contractors.
hire more minority workers into more demanding positions, they may encounter equal productivity between blacks and whites in the same positions. Hence, their beliefs may change so that they have homogenous beliefs concerning all workers. This is the first “good” possibility of affirmative action equilibrium. The second possibility is that because affirmative action lowers the standards for higher-level positions for minorities, it does not require minorities to invest in human capital in order to be placed into a more demanding position. Blacks do not invest in the relevant skills needed for a job because they feel they can succeed without them, due to affirmative action. Because minorities have been investing in less human capital, while being placed in more demanding positions, the negative stereotypes of the employers will once again be confirmed. What then develops is a “patronizing equilibrium” and the gap in productivity between the minorities and the majority widens even further. The emergence of this patronizing equilibrium is dependent upon the benefits the worker receives from being placed in a higher-paying, more demanding job versus the cost of acquiring skills. Coate and Loury acknowledge the ambiguity in affirmative action and recognize that it is not possible to determine which equilibrium outcome affirmative action will produce.

At this point it is important to evaluate affirmative action from a reformed standpoint using the foundational framework outlined in section II of this paper. Once again, Hay’s Biblical principles for economic life will provide a solid groundwork for this evaluation. As far as offsetting the effects of discrimination are concerned, affirmative action is a possible solution in that it may raise wages and increase employment growth for blacks employed in firms which are bidding for government contracts and are under continual review by the EEOC. Discrimination is also offset in
the “good” equilibrium of the Coate and Loury model. Affirmative action aims to solve the brokenness created by discrimination. As discrimination limits one’s opportunity to work it also limits his/her means of exercising stewardship. It restricts the social aspect of work because it hampers the ability to work as joint stewards. As access to work is limited, access to resources is also limited. Affirmative action potentially solves these problems by bringing blacks back into the workplace.

However, as we have seen from Coate and Loury, the outcomes of affirmative action are also uncertain. The above benefits of affirmative action are experienced under Coate and Loury’s “good” equilibrium. Affirmative action may also fall quite short in its ability to solve the problems of discrimination when the “bad” equilibrium is the outcome. While affirmative action may lift the limits on the ability to work, it still does not allow blacks to work to their full potential. Hence, as their levels of human capital remain low, their ability to exercise stewardship and responsibility over resources also remains limited. Affirmative action may be unable to bring a complete answer to the problems of discrimination; it brings back blacks’ entitlement to work, but not in a complete sense. It is important to realize that because of the fall, one cannot expect institutions and policies to be able to completely solve the problems created by the fall. These institutions are operating in a fallen way too, as seen in Coate and Loury’s “bad” equilibrium. Furthermore, this paper will now recommend what more “complete” answer to discrimination may lie beyond affirmative action.

An alternative solution to the problem of discrimination may lie in enforcing equal wage scales as discussed in the theoretical work of Lundberg and Startz (1983). Lundberg and Startz present a theoretical model to explain the wage gap through
employers’ perceptions of a “test score.” In their model, firms determine wages by using some “test score” of ability or productivity as a means of assessing an entire group. The problem in this approach lies in the fact that blacks may have a greater test score variance than whites. In other words, the test is not as accurate an indicator of ability for blacks as it is for whites. The test is not as valid a measure of ability for blacks as it is for whites. Lundberg and Startz hypothesize that because of this, employers will place less importance on blacks’ individual test scores when they are hiring or promoting blacks and will rely more on the mean test score for blacks. When an employer hires or promotes a white they put more weight on the individual test score, as it is a more accurate representation of ability. Thus, in this model, whites have a greater incentive to invest in education and human capital to raise their test score. The employer then pays employees the mean marginal productivity of their group test score plus a portion of their individual test score. Whites and blacks have the same mean, but because of the greater variance in black test scores, blacks are getting a smaller piece of their individual test score in their wage. Like Coate and Loury, Lundberg and Startz find that this cycle causes blacks to invest in less human capital. Rather than affirmative action, Lundberg and Startz recommend a strict enforcement of equal wage scales for blacks and whites according to ability. As a result blacks will slowly “gather up” a greater incentive for human capital investment as they see the benefits of equal wages that come as a result. What Lundberg and Startz fail to account for is how to get blacks to believe that this wage scale will truly be enforced or implemented. There still remains expectation of discrimination.
Where Lundberg and Startz leave off, Coate and Loury pick up with a more complete solution to encouraging greater human capital investment on the part of blacks. Over time a worker receives a decreasing marginal benefit to years of education, and eventually they will reach a point at which the cost of investing in human capital is equal to the marginal benefit received from one more year of education. This is seen in the following diagram\(^7\):

\[ \text{MB of Education} \]

\[ \begin{array}{c}
\text{Years of Education} \\
\end{array} \]

In this diagram “\(r\)” represents the investment cost of one more year of education and \(\text{MB}_1\) represents the marginal benefit received from that education. A worker will invest in education until the marginal cost equals the marginal benefit, at point \(E_1\). Because blacks perceive that they will receive less marginal benefit from education than whites, this investment level is lower for blacks than whites. Rather than lowering standards for blacks and causing a disincentive to invest in human capital, Coate and Loury recommend increasing the marginal benefits to education for blacks. If blacks anticipate labor market discrimination they are not likely to invest in human capital. However, if there is a greater incentive to investing in human capital, such as a subsidy to

\(^7\) Adapted from Kimenyi (1995).
their income when they attain a higher level position, blacks will then be more likely to invest in the human capital needed to attain that higher-level position. As blacks invest in greater human capital the negative stereotypes of employer will change as they are now encountering blacks with higher human capital and higher productivity than previously.

Coate and Loury also evaluated the possibility of offering the subsidy to employers for promoting blacks; however, this does little more than perpetuate the same problem caused by affirmative action. It causes employers to lower their standards which in turn leads to lower worker performance again exacerbating the problem of negative stereotypes.

There is one other exception to the wage subsidy solution. If an employer’s views of black workers are so negative that they will never assign them to a higher level position, then blacks will never invest in more human capital, no matter how great the income subsidy for acquiring a higher level position. It is in this situation that a policy of affirmative action would need to be initiated to make any progress.

Coate and Loury’s overall argument is that if ending discrimination entails ending negative employer stereotypes, then in most cases it is better to encourage human capital accumulation rather than bribing or coercing employers into hiring or promoting blacks.

The problem in this model is in its implementation. In order to be effective in encouraging blacks to invest in human capital to overcome expected discrimination, there must be this necessary subsidy to human capital accumulation. There must be a policy that gives a subsidy to blacks as a reward for attaining a higher level position. What becomes difficult is how such a policy could be approved by the state. It is the state’s responsibility to ensure that man’s right to work is upheld along with the other guidelines
outlined previously by Donald Hay, but this particular policy recommendation carries
with it a significant amount of stigma in its method. Given the current lack of
overwhelming minority representation in federal government and the fallenness of the
state as an institution, it may be difficult to get such a policy backed.

What still slips through the crack, as far as policy measures are concerned, is labor
market-related discrimination. These are discussed in further detail below.

One type of labor market related discrimination that affects black wages, yet does
not arise from the employer, is customer discrimination. Holzer and Ihlanfeldt (1998)
have found that greater job suburbanization along with a decline in manufacturing and
greater growth in services has led to more face-to-face contact between employees and
customers. They perform a regression of race of employee on the percentage of minority
customers, characteristics of last worker hired and firm characteristics. They find that
the hiring of blacks rises with the percentage of customers that are blacks. This could
lead to the potential for crowding of blacks into non-discriminatory sectors, or crowding
into those sectors that have a greater percentage of minority customers. Flooding these
employment markets can lead to a decline in wages for blacks, and Holzer and Ihlanfeldt
recognize the need for further research on the topic.

Another form of labor market-related discrimination is discrimination in small
business loan approvals. Blanchflower, Levine, and Zimmerman (1998) have studied
data from the Federal Reserve Board and the U.S. Small Business Association, and they

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8 This includes employee characteristics such as education, references and training and firm characteristics
such as location, availability of public transportation and distance to nearest white and minority
neighborhoods. The last worker hired is used to avoid the problem of time variance in the data. The current
composition of the customer base is most likely to affect the most recent worker hired.
run regressions of probability of loan approval on characteristics of the business. They find that black firms are 25% more likely to have their loan applications denied. Following Becker’s (1957) definition of discrimination, they find that this figure is attributable to discrimination in the lending market for small business loans. As Becker states, “Discrimination results from the desire of owners, workers or customers to avoid contact with certain groups. This being the case, transactions with the undesired groups would require more favorable terms than those that occur with a desired group.” In the case of small business loans this can lead to more rigorous terms for loans that are approved for minorities, although further research is still needed. It is on this point of further research that Heckman (1998) is likely to agree with Blanchflower, Levine and Zimmerman. As long as economists do not have access to all the variables and data that banks use in making their lending decisions, the economists’ results will fall short of being able to fully explain the lending outcomes. Blanchflower, Levine and Zimmerman also bring up an issue that has been seen already in this paper, the problem of expected discrimination. If black small businesses expect to be denied credit, they are likely not to apply at all.

V. Conclusion

As has been shown through the above studies, it is not easy to come to a consensus concerning the need for and effectiveness of affirmative action. The best way to understand affirmative action begins by determining the exact problem that affirmative action is trying to solve. From there one can evaluate if it has solved this problem and

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9 The independent variables included size, age and organization type of the firm, education of the owner, location and industry type. They also controlled for firm credit-worthiness through variables for past
what other unintended consequences may have also come as a result of affirmative action. In doing this, one must not neglect the importance of one’s own worldview in the evaluation.

The first question addressed in this paper is whether or not there is evidence of current labor market discrimination. Is there still a reason to have affirmative action? Economists are quite divided on this issue and there is much debate over different research methodologies. It is recognized that there is a significant wage gap between blacks and whites, but a controversy arises as to what that wage gap is attributable to. Darity and Mason (1998) attribute this gap to current labor market discrimination. However, Nobel Laureate James Heckman (1998) finds a number of faults in their methodology including their use of “human capital variables.” He finds that Darity and Mason do not completely control for human capital in their regressions. There are more factors of human capital and productivity that an employer uses in their hiring and promotion decisions than is used in Darity and Mason’s study.

Neal and Johnson (1996) are able to attribute a large amount of the black/white wage gap to pre-labor market conditions through the use of the Armed Forces Qualification Test as a pre-labor market predictor of skills and productivity. Nonetheless, Neal and Johnson still find a 7% wage gap that cannot be explained through the use of the AFQT test. While Heckman agrees with the methodologies of Neal and Johnson, he continues to conclude that there is no current labor market discrimination.

Additionally, there are other forms of labor market related discrimination that can contribute to the black/white wage gap. Holzer and Ihlanfeldt find a positive correlation between the race of customers and employees. Discrimination among customers can lead

bankruptcy, legal judgements, and sales strength.
to blacks being crowded into employment sectors where customers are not discriminatory or are themselves black. Blanchflower, Levine and Zimmerman find evidence of discrimination against blacks in small business loan approvals. Blacks are less likely to be approved for small business loans and could be more likely to experience higher interest rates and tougher parameters.

One last factor that is recognized by both Heckman and Blanchflower, Levine and Zimmerman is the expectation of discrimination. If blacks expect to be discriminated against in the labor market they are not likely to apply for a job at all. Likewise if blacks expect discrimination in the small business credit market they are not likely to apply for a loan.

In light of the fact that there is not a consensus in the field, it is difficult to make a definitive statement as to whether or not the remaining wage gap may be attributed to current labor market discrimination. The findings of this paper are that there is little significant current labor market discrimination. There is still approximately a 7% wage gap, and as a result, this paper chose to evaluate affirmative action as a solution to that remaining wage gap.

Jonathan Leonard has studied the income and employment effects of affirmative action and found that affirmative action increases the growth rate of black employment, but only in firms bidding for government contracts. It is in these firms that one would expect to find the highest compliance with the government’s wishes since the firms are competing for government contracts. It is in their best interest to hire minorities. It may also be that these firms are hiring less qualified employees simply to win the government contract. Leonard does find that these firms were fast-growing firms, utilizing large
amounts of unskilled labor. He also finds that the narrowing of the black/white wage gap, which occurred during the time when affirmative action policies were heavily enforced, actually subsides as less emphasis is placed on affirmative action during the 1980s. At the same time, he recognizes the great lack of literature concerning the effects of affirmative action and the numerous confounding effects, during the 1980’s especially, that make studying affirmative action’s effects quite difficult.

Yet in order to be comprehensively effective, affirmative action cannot merely be evaluated based on the numbers it can produce. It is also important to view it in light of what it does for blacks’ right to work, including their ability to access resources. Both Loury and Coate in their “bad” affirmative action equilibrium and Lundberg and Startz believe affirmative action may be contributing to the lack of human capital for blacks. As affirmative action lowers standards for blacks it creates a disincentive for them to invest in human capital. Lundberg and Startz find the solution to this in a stricter enforcement of equal wage schedules. This paper finds this still to be an incomplete solution since it does not address blacks’ expectation’s of discrimination in the labor market.

It is here that Coate and Loury provide an affirmative action alternative that does not seek to fix the problem in the labor market, but back in the pre-labor market where Heckman strongly argues that the wage gap first begins to formulate. In order to increase black’s human capital accumulation, the benefits to blacks from that education must increase. Coate and Loury propose a wage subsidy to blacks who achieve higher level jobs. The greater return from achieving that higher level job will override any expectations of discrimination in the labor market. Thus, even if blacks do follow the
thinking of Darity and Mason that there is current labor market discrimination, the wage subsidy that they receive from accumulating greater human capital for a higher level job will prevail over the expectation of discrimination. This alternative does not limit blacks’ abilities to gain access to resources as affirmative action limits their incentive to accumulate human capital. Rather, it encourages them to live up to their full potential and use the talents they have been given to be a productive worker.

Coate and Loury find not just a “bad” equilibrium, but also a “good” equilibrium” and it remains ambiguous as to which will prevail. However, their wage subsidy solution removes this ambiguity; there is no longer a possible negative equilibrium. With their wage subsidy solution, as blacks perform well at their job, employers’ expectations and beliefs will change concerning black workers. The subsidy solution will eventually eliminate employers’ negative stereotypes, while affirmative action only offers this elimination as one of two possible equilibria.

While this paper does find the ideas of Coate and Loury to operate in the best interest of blacks as an affirmative action alternative, it also recognizes the difficulties that may arise in implementing the ideas of Coate and Loury. The state is a fallen institution and does not always function in the most equitable way. Men will operate within their own self interests, and, with a limited number of minorities in government policy-making positions, it will be difficult to get such policy passed.

Additionally, further research is needed in order to build a firm foundation for Coate and Loury’s propositions. There is still much debate as to the causes of the black/white wage gap. Economists need access to more of the information used by firms’ personnel departments in their hiring and promotion decisions in order to measure
adequately the factors affecting employment. Furthermore, subsequent research is needed concerning the effectiveness of affirmative action. Much has been written on affirmative action policies, but a good deal of it concerns the political agenda of the author and neglects the direct wage and employment growth studies reviewed in this paper. Even then, the empirical research that has been done on affirmative action still lacks much of the information it needs to fully evaluate whether changes in black employment may be attributable to affirmative action. As the extensiveness of the research on affirmative action and discrimination grows, so too, can the precision in evaluating these issues continue to develop. Primarily, in order to implement best Coate and Loury’s model of wage subsidy, further research is needed pertaining to human capital accumulation. A better understanding of what causes human capital accumulation among blacks and how it can be further emphasized will aid in future policy decision making concerning black employment.
Appendix

Chronological Timeline of Events Concerning Affirmative Action in Employment
(Adapted from Eisaguirre 1999)

1961 Shortly after he takes office, President John F. Kennedy is probably the first person to use the term “affirmative action” and link the term to civil rights. By signing Executive Order 10925, he establishes the Equal Employment Opportunity Commission (EEOC) and declares that people in the construction industry have certain obligations when doing business with the government. The order states, in part: “The contractor will take affirmative action to ensure that applicants are employed, and employees are treated during their employment, without regard to their race, creed, color, or national origin.” The language is broad in its scope and offers no detailed definition of affirmative action.

1964 In response to massive rebellion and demonstrations in Cleveland, New York, Chicago, Philadelphia, Jersey City and Los Angeles, Congress signs into legislation the Civil Rights Act, originally proposed by President Kennedy before his death. The act would outlaw discrimination in employment and officially create the EEOC. The bill prohibits discrimination based upon race, color, origin, or national origin as well as gender. They declare that no part of the law is designed “to grant preferential treatment to any group because of race, color, religion, sex or national origin.”

1965 In September, President Johnson issues Executive Order 11246, requiring firms conducting business with the federal government to take affirmative action to attain equal employment opportunity.

1966 The Department of labor begins to include employees race in their personal records in an attempt to begin evaluating hiring practices. The Office of Federal Contract Compliance (OFCC) is also created to tighten affirmative action requirements. Contractors engaged in government work are required to present a “written affirmative action compliance program” detailing steps guaranteeing equal employment for minorities including the development of specific goals and timetables.

1967 The City of New York, the Roman Catholic Church in Michigan and Neiman Marcus all announce plans requiring their suppliers and contractors to take affirmative action steps toward hiring African Americans.

1969 The first official government affirmative action program- the Philadelphia Plan- is devised by President Nixon. Secretary of Labor George Schultz makes demands on the segregated Philadelphia construction industry, requiring more minority hiring and even setting percentages and goals.

1970 Having found that affirmative action can help raise profits, companies such as Dow chemical make voluntary efforts to diversify their work force.

1973 The EEOC takes the position that all employers within its jurisdiction- not just those receiving federal funds- must institute result-oriented affirmative action programs.

1975 At the University of California at Berkley, the faculty of the law school votes to eliminate Asian Americans from minority admissions, sparking a national trend to exclude Asian Americans from affirmative action programs.
1979  *United Steelworkers of America v. Weber* is decided by the Supreme Court. The case approves a voluntary plan adopted by a union and aluminum manufacturer that calls for half of the openings in training programs to be reserved for blacks until such a time as the share of black craft workers approximates that of blacks in the local labor force.

1984-1989  President Reagan severely undercuts the work of previous administrators to develop and strengthen affirmative action: he appoints two Supreme Court justices who are known to oppose affirmative action, and he cuts the budgets of the EEOC and the OFCC, seriously limiting their ability to pursue affirmative action cases.

1991  The Supreme Court decides in *Metro Broadcasting Inc. v. FCC* that when the purpose of an affirmative action program is benign, the courts should inspect it less closely.

1992  Presidential candidate Bill Clinton declares he owes the nation “a cabinet that looks like America, but that meet high standards of excellence.” After elected, he appoints three women, fours African Americans and two Hispanic Americans to his cabinet.

1995  President Clinton gives a major speech in support of Affirmative Action claiming “mend it, don’t end it.”

1996  The U.S. court of Appeals for the Fifth Circuit strikes down an affirmative action program at the University of Texas School of Law. The majority opinion rules that an earlier ruling—that securing the benefits of a diverse student body is a compelling interest for a public university—is no longer a good law. The Supreme Court chooses not to review the case. It is now illegal for race to be considered as real factor in admissions decisions for public school in Texas.

1996  California passes Proposition 209, which limits affirmative action in California.

1997  A three-judge panel lifts an injunction placed on Proposition 209 and declares that it is constitutional.

1999  The Center for Individual Rights (CIR), a Washington, D.C., public interest law firm, files lawsuit against the law schools at the University of Michigan and the University of Washington, challenging their affirmative action in their admissions programs.
Bibliography


