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## **Discrimination in the Post-Civil Rights Era: Beyond Market Interactions**

Glenn C. Loury

**T**he literature reviewed in the three main papers in this symposium focuses on discrimination against women and blacks in labor, credit, and consumer goods markets. Each paper makes the point that such discrimination persists, and it is a point worth making. But when considering the topic of racial or gender discrimination, economists should be willing to look beyond what happens within markets.

Of course, we economists have a professional tendency to focus on how markets work or fail. Economic theory suggests that discrimination based on gender or racial identity should be arbitrated away in markets of competitive sellers, employers and lenders. In fact, however, such discrimination is readily observed in society, and this anomaly attracts attention. Critics of the neoclassical orthodoxy in economics seize upon it, and defenders of that orthodoxy seek to explain it away. Thus, evidence that wage differences between the races or sexes have declined, after controlling for worker productivity, is supposed to vindicate the economist's belief in market forces.

I think this way of approaching the problem is too narrow. With respect to wages, for example, the usual focus is on the demand side of the labor market—employers either have a so-called “taste for discrimination,” or are thought to use race as a proxy for unobserved variables that imply lower productivity for blacks. The primary normative claim in this approach is that such discrimination is morally offensive, a legitimate object of regulatory intervention, and a significant contributor to the scourge of race and sex inequality in society. But also implicit here is the notion that if inequality were due to supply side differences—in the skills pre-

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sented to employers by blacks and whites, for example—then the resulting disparity would not raise the same moral issues, nor give a comparable warrant for intervention. With respect to housing markets, there is a comparable view—that residential segregation induced by the discriminatory behavior of realtors is a more severe problem than the segregation that comes about because of the freely chosen decisions of market participants.

## **A New Emphasis**

In this comment, I want to propose a shift of emphasis. While market discrimination against blacks still exists, it is not as significant an explanation for racial inequality in the United States as was the case in decades past. This calls into question the conventional wisdom regarding equal opportunity policy—the view that eliminating racial discrimination in markets will lead, eventually, to a solution for the problem of racial economic inequality. I submit that the substantial skills gap between blacks and whites is a key factor in accounting for racial inequality in the labor market. I see this skills gap as a reflection of social and cultural factors—geographic segregation, deleterious social norms and peer influences, and poor educational quality—that have a racial dimension (Cutler and Glaeser, 1997; Akerlof, 1997). In this view, racial inequality is also a supply side problem that cannot be fully understood, or remedied, with a focus on market discrimination alone.

In stating this, I do not mean to suggest that conventional efforts to combat discrimination should be suspended. Evidence surveyed in this symposium impressively supports the view that markets do not convert personal characteristics into economic outcomes in the same manner for blacks and whites. This result is quite robust. Across different markets, in varied data sets, and with alternative methods of investigation, one consistently finds blacks being adversely treated. In labor markets this adverse treatment involves not only lower wages earned by (or offered to) black workers, but also greater difficulty for them in securing employment (Wolpin, 1992; Holzer, 1994).

But the evidence of a gap in acquired skills that at least partly explains racial wage disparities is also impressive. In the National Longitudinal Survey of Youth (NLSY) data set, there is a one standard deviation difference between the mean scores of young blacks and whites on the Armed Forces Qualification Test (AFQT), only about half of which is accounted for by racial differences in schooling and family backgrounds (Neal and Johnson, 1996). When a panel from the National Academy of Sciences studied the AFQT, they found no evidence of racial bias in the capacity of that test to predict military job performance (Wigdor and Green, 1991). Comparable racial disparities arise in other samples, using other measures of cognitive skill. Though the gap has narrowed in the past generation, the National Assessment of Educational Progress (NAEP) continues to reveal a substantial difference in the academic proficiency of black and white secondary school students. In the 1994 NAEP, the average black at age 17 performed only slightly better in

reading and mathematics than did the average white at age 13 (National Center for Educational Statistics, 1996). There is evidence that quantitative literacy skills, measured by a simple test of the ability to do arithmetic, have a significant relationship to employment and earnings for young men (Rivera-Batiz, 1992).

There is a long history of justified concern that an approach to the problem of racial inequality that focuses less on employer discrimination and more on skills differences could foster dangerous stereotypes, and undermine arguments for policies to narrow the racial wage gap. In the decade after the enactment of federal anti-discrimination laws, researchers like Freeman (1973) and Wilson (1978) who began to find evidence of a decline in labor market discrimination were sometimes criticized for giving aid and comfort to political conservatives. However, this reaction accepts the implicit normative assumption that racial inequality based on skill disparities is not as important a moral problem, warranting as vigorous a corrective intervention, as inequality based on wage discrimination in the labor market. That assumption is not compelling. It should be challenged.

## **Social Networks**

Economic analysis begins with a depersonalized agent who acts more or less independently, seeking to make the best of the opportunities at hand. This way of thinking has been very fruitful for economics, but it cannot adequately capture the ways that racial inequality persists over time. In actuality, individuals are embedded in complex networks of affiliations: they are members of nuclear and extended families; they belong to religious and linguistic groupings; they have ethnic and racial identities; they are attached to particular localities. Each individual is socially situated, and one's location within the network of social affiliations substantially affects one's access to various resources.

Opportunity travels along the synapses of these social networks. Thus, a newborn is severely handicapped if its parents are relatively uninterested in (or incapable of) fostering the youngster's intellectual development in the first years of life. A talented adolescent whose social peer group disdains the activities that must be undertaken for that talent to flourish is at risk of not achieving full potential. An unemployed person without friends or relatives already at work in a certain industry may never hear about the job opportunities available there. An individual's inherited social situation plays a major role in determining ultimate economic success.

In earlier work, I have suggested an extension of human capital theory designed to provide a richer context within which to analyze group inequality (Loury, 1977, 1981, 1987). This theory builds upon observations concerning the importance of family and community background in determining individual achievement. In this theory, one's investment in productive skills depends on one's position in the social structure, due to imperfect capital markets for educational loans that necessitate reliance on finance through personal ties, social externalities mediated by residential location and peer associations, and psychological processes that shape

a person's outlook on life. As a result, familial and communal resources—that is, social and cultural capital—explicitly influence a person's acquisition of human capital. Some important part of racial inequality, in this view, is seen to arise from the way that geographic and social segregation along racial lines makes an individual's opportunities to acquire skills depend on skill attainments by others in the same social group.

There is fairly strong support for this view of the lagging economic position of blacks in the literature. Akerlof (1997) provides a theoretical argument, supported by a wealth of evidence from social anthropology, for the notion that concerns for status and conformity are primary determinants of individuals' educational attainment, childbearing, and law-breaking behavior. Anderson (1990) provides an ethnographic account of life in inner city Philadelphia in which peer influences significantly constrain the acquisition of skills by adolescents in those neighborhoods. Waldinger (1996), in a study of immigrant labor in New York City, concludes that poor blacks suffer less from the racism of employers than from the fact that they do not have access to the ethnic networks through which workers are recruited for jobs in construction and service industries. Glaeser and Cutler (1997), comparing U.S. cities with varying degrees of racial population concentration, find blacks to be significantly disadvantaged by residential segregation; they estimate that a 13 percent reduction in segregation would eliminate about one-third of the black-white gap in schooling, employment, earnings, and unwed pregnancy rates. Mills and Lubuele (1997) argue that a central problem for students of urban poverty is to explain why "low income black residents actually or potentially eligible for jobs that have moved to suburbs (have) not followed such jobs to the suburbs."

## **Beyond Market Discrimination**

All of this suggests the inadequacy of seeing discrimination or anti-discrimination efforts only within a market framework when discussing racial inequality. Conventional economic discrimination against blacks is probably not the primary source of race disparities. Moreover, available methods for fighting such discrimination have little power to reduce the economic gap between the races. For over a decade now the bulk of the federal anti-discrimination apparatus has been occupied with the complaints of non-black plaintiffs—persons bringing claims under age, disability, and sex discrimination statutes (Smith, 1993). In one important area—transactions between business concerns—penalties for practicing racial favoritism are negligible, because the very illegality of discrimination has yet to be clearly established (Suggs, 1991). Moreover, given the informational asymmetry between employers and enforcement agents, there are limits to how aggressive anti-discrimination policy can be before one encounters significant efficiency costs (Coate and Loury, 1993a). Unlike Epstein (1992), I do not think we should repeal the Civil Rights Acts or dismantle the Equal Employment Opportunity Commission.

But I do think that, if the concern is economic inequality between the races, then looking mainly through the lens of wage and price discrimination is unlikely to shed much light on the problem.

There is another, more fundamental, reason to broaden the discussion of racial inequality beyond the context of market discrimination. In cities across the country, and in rural areas of the Old South, the situation of the black underclass and, increasingly, of the black lower-working classes, is bad and getting worse. This is certainly a race-related problem. The plight of the underclass is not rightly seen as another (albeit severe) instance of economic inequality, American-style. But conventional market discrimination is only one small part of it. These black ghetto dwellers are a people apart, susceptible to stereotyping, ridiculed for their cultural styles, isolated socially, experiencing an internalized sense of helplessness and despair, with limited access to communal networks of mutual assistance (Anderson, 1990; Wilson, 1996). Their purported criminality, sexual profligacy, and intellectual inadequacy are the frequent objects of public derision. They suffer a stigmatized pariah status (Goffman, 1963). It should not require enormous powers of perception to see how this degradation relates to the history of black-white race relations in this country.

Here is where the implicit normative model that accompanies the emphasis on market discrimination is most seriously flawed. Given social segregation along race lines, the effects of past discrimination can persist over time by adversely affecting the skills acquired by the offspring of those discriminated against. Moreover, discrimination in one market can leave its victim less well prepared to compete in another market. The cumulative impact of an act of discrimination—over time and across markets—should be no less problematic, as an ethical matter, than was the original offense.

The civil rights struggle, which succeeded brilliantly in winning for blacks the right to be free of discrimination, failed for the most part to secure a national commitment toward eradicating the effects of discrimination which had already occurred. When those effects manifest themselves in patterns of behavior among poor blacks which lead to seemingly self-imposed limits on their acquisition of skills, the tendency of many who think only in terms of market discrimination is to argue that society is not at fault. This is the grain of truth in the insistence of some observers that, while overt racism was implicated in the past, it is behavioral differences that lie at the root of racial inequality in contemporary America (Thernstrom and Thernstrom, 1997). But the deeper truth is that, for quite some time now, the communal experience of the descendants of the African slaves has been shaped by political, social and economic institutions that, by any measure, must be seen as oppressive. When we look at “underclass culture” in the American cities of today, we are seeing a product of that oppressive history. In the face of the despair, violence, and self-destructive behavior of these people, it is morally obtuse and scientifically naïve to argue, as some conservatives now do, that if “those people” would just get their acts together, then we would not have such a horrific problem. Yet for the same reason, it is also a mistake to argue, as some liberals do, that the

primary causes of continuing racial inequality are based on ongoing market discrimination.

There are significant market failures, having little to do with economic discrimination as conventionally understood, that play a powerful role in perpetuating racial inequality. Consider the problem of residential segregation (Massey and Denton, 1993). Compelling theoretical arguments (Schelling, 1978, ch. 4) and recent computer simulations (Wayner, 1998) suffice to show that even a mild desire for people to live near members of their own race can lead to a strikingly severe degree of segregation in the aggregate. Adding class concerns to these models only strengthens their predictions of geographic clustering. Moreover, residential location is not the only venue in which segregation occurs. Linguists studying speech patterns in urban centers have uncovered quite strong evidence of race and class separation (Labov, 1982). There is reason to suspect that race differences in communicative styles could play an important role in accounting for the adverse labor market outcomes of low income blacks (Lang, 1986; Cornell and Welch, 1996; Charles, 1997; Wilson, 1996).

Even though residential and social segregation based on race may be the natural result of non-discriminatory market interactions, it could still have morally disturbing consequences. Even if those consequences manifest themselves mainly on the supply side of the labor market, a strong case could still be made for doing something about them. That case need not be based solely on equity grounds. Indeed, once it is admitted that preferences and investment in skills of market participants are influenced by social and psychological externalities, the conventional results in welfare economics concerning the efficiency of market outcomes are no longer generally valid.

As an example of a social externality, consider the dissonance associated with holding values at some distance from one's peers. If groups help sustain norms, with each individual looking to the apparent preferences of his or her peers to infer the appropriate behavior, then there is a possibility of multiple self-sustaining norms (Akerlof, 1997). Generalizations about differences between groups in attitudes toward work, family life, criminal participation, and the like may thus be empirically correct, but morally irrelevant. Moreover, with multiple self-sustaining norms, acting to shift the norm can lead to Pareto-improvements in welfare (Sunstein, 1996).

A psychological externality can occur when individuals draw upon their own encounters with the market, and the encounters of others to whom they are socially connected, to reach conclusions about, say, the extent to which effort accounts for market rewards—as opposed to ability or luck. In this scenario, the degree to which an individual believes that bad personal outcomes are due to inadequate personal “effort” can depend on the aggregate performance of other members of the group. Self-fulfilling pessimism about the returns to effort for certain activities, like academic pursuits, are possible in a model like this (Steele, 1992).

I am not suggesting that these social and psychological externalities are the primary explanation of racial inequality. But they are not implausible accounts of how social segregation might support behavior patterns that lead to a skills gap

between racial groups. Furthermore, these scenarios (and others that could be sketched) suggest that policies directed at reducing the skills gap might be just as morally required, and even more efficacious, than policies directed against such market discrimination as may still exist.

## Thoughts on Statistical Discrimination

It is useful to distinguish between the taste-based theories of discrimination that originate with Becker (1957), and information-based theories of statistical discrimination derived from the work of Arrow (1972), Phelps (1972), and Aigner and Cain (1977). My own view, elaborated at greater length in Coate and Loury (1993b), is that information-based models afford a more realistic account of the market discrimination encountered by blacks today. Race is an easily observable trait that, as an empirical matter, is correlated with some hard-to-observe traits about which employers, lenders, police officers and others are concerned. Direct evidence from employer interviews indicates that both black and white employers are reluctant to hire black, urban young males who exhibit lower-class behavioral styles (Wilson, 1996). Racial identity is also used as information in a variety of ways by police. Some evidence indicates that it shapes their law enforcement decisions (Applebaum, 1996). Indeed, the dramatic disparity between the races in the rates of arrest and incarceration for criminal offenses (Tonry, 1995) must be taken into account when discussing racial differences in the labor market experiences of males, though the direction of causality is not obvious.

Statistical discrimination can be quite damaging to both the efficiency of market allocations and to equity. This is due to the very real possibility that the empirically valid statistical generalizations lying at the heart of such discrimination can be self-fulfilling prophecies (Lundberg and Startz, 1983; Coate and Loury, 1993b). I believe that statistical racial discrimination should be treated with legal suspicion, although the enforcement problems in this area are very difficult. However, it is not difficult to give straightforward economic accounts of how this process might work in a variety of contexts.

Suppose only a few taxi drivers will pick up young black men after a certain hour. Given that behavior by taxi drivers as a class, it is plausible through a process of adverse selection that the “types” of young black men who will attempt to hail taxis during those hours contain an especially large fraction of potential robbers. This makes it rational to avoid them. But if most drivers willingly picked up young black men, then this behavior might induce a less threatening set of black males to select taxi transportation after dark, confirming the rationality of the drivers’ more tolerant behavior.

Or, suppose employers have an a priori belief that blacks are more likely to be low effort trainees than are whites. Then, they will set a lower threshold for blacks on the number of mistakes needed to trigger dismissal, since they will be quicker to infer that black workers have not tried hard enough to learn the job. But knowing



that they are more likely to be fired for making a few mistakes, more black employees may elect not to exert high effort during the training period in the first place, thus confirming the employers' initial beliefs.

Or, if car dealers believe that black buyers have higher reservation prices than whites, then dealers will be tougher when bargaining with blacks than with whites. Given this experience of tough bargaining, a black buyer anticipates less favorable alternative opportunities and higher search costs than a white buyer, and so (depending on the specifics of the bargaining pattern) may rationally agree to a higher price. This behavior confirms the dealers' initial presumption that "color" predicts bargaining power.

Such stories are not difficult to produce, and at least to my ear, they have a certain ring of truth about them. The key to all of these examples is their self-reinforcing nature: they begin with racial beliefs that then bring about their own statistical confirmation. There is an especially disturbing variant of this process, which deals with the persistence of prejudice. Consider two situations: 1) a homogeneous population, each member of which will engage in a criminal activity with probability  $1/10$ ; and 2) a heterogeneous population harboring 10 percent bad guys who engage in criminal activity on every occasion, and 90 percent good guys who never do. Let's say that in actual fact, situation 2 obtains, but that a law enforcement agent erroneously believes that situation 1 is the correct model. Let that enforcement agent observe the behavior of a randomly chosen individual from the population, and also be informed about the aggregate rate of criminal offending. No matter what the observed outcome at the individual level, this enforcement agent never changes his beliefs, because in the aggregate, 10 percent of the population is always reported to have engaged in criminal activity. Moreover, this agent has no incentive to "tag" and keep track of the individual histories, given his model of what is generating his observations, since he anticipates no gain from such tracking. This agent will never learn that his model is wrong!

Such examples are not unrelated to the historical problems of race, as they have developed in our society. Race is an easily discernible characteristic that has salience in our culture, making it operate powerfully in many venues precisely because it is common knowledge that people are taking it into account. It is my conviction that the notion of market discrimination is simply not rich enough to capture the many troubling variants of this phenomenon.

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