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Gender and ethnic wage differentials inhibit growth: A shred of evidence

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Abstract

Racial, ethnic, and gender wage differentials, in particular those that are not explained by human capital differences between the respective groups, are fixtures of labor markets in almost all countries, developed and developing alike. Discriminatory wage differentials have detrimental social and economic effects. Gender differentials have larger distortional effects than other ethnic and racial differentials, and might call for different policies to address them. Measuring and documenting wage and employment differentials is an essential first step towards eliminating these differentials, which in turn is a very important economic as well as social policy goal akin to the Sustainable Development Goals set by the international community.

Keywords: Gender wage gap, ethnic wage gap, discrimination in the labor market, economic growth, wage differentials, economics of transition, labor market tightness

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Gender and ethnic wage differentials inhibit growth: A review of evidence

Introduction

Differentials in labor-market outcomes (mainly wages and employment), in particular those that cannot be explained by human capital differences between groups, lead to a misallocation of resources in the economy. This means that, beyond the well-documented social aspects of inequality and discrimination, labor-market differentials result in underutilized resources and thus suboptimal outcomes in the economy. Whether the observed wage and employment differentials are partly or fully attributable to labor market discrimination, policies should be implemented to eliminate these differentials, as they have direct detrimental economic and social consequences. Developing and transition countries are even more vulnerable to these negative effects.

The negative effect of gender wage differentials on economic growth is substantially larger than the effect of ethnic differentials, simply because females constitute a larger share of the population than any ethnic or racial minority group. However, women seem to be harmed more by different treatment in the labor market (akin to direct discrimination) rather than by human capital differences; hence, affirmative action policies might be more appropriate for tackling gender wage differentials, yet policies enriching the human capital of minority groups are more suitable for tackling ethnic discrimination.

Wage differentials and discrimination

Wage differentials, and for that matter differentials in employment or other outcomes, are not always caused by discrimination. However, wherever large differentials are observed, discrimination is likely to explain part of those differentials, although its exact measurement might be difficult (Longhi 2020). Moreover, discrimination might be direct due to current labor market factors, or it could be the result of premarket factors, for example, differentials in access to education and in the quality of education received, and other human-capital factors that are affected by the socioeconomic status and the background of the family.

In the market, discrimination can result from the prejudice of employers, employees, or customers in what is called “taste discrimination.” (Becker 1957). It can also result from, and be perpetuated through, “statistical discrimination,” in which employers use statistical facts and beliefs about workers’ productivity and skills to

make hiring decisions (Phelps 1972). The existence of discrimination and wide disparities in opportunities, employment, and wages might induce discriminated workers to underinvest in their human capital, which serves to reinforce beliefs about their inferior skills and thus perpetuate the disparities observed in the market.

Discrimination measurements

The observed wage gaps between any two groups, such as the minority and the majority, males and females, or different racial or ethnic groups, can be measured by comparing the actual wages of the two groups, which is performed using regression analysis with a single qualitative variable that distinguishes the comparison groups in question. This is the observed, or unadjusted, wage gap. To make the comparison between observationally equally productive workers in the different groups, we control for differences in their human capital characteristics by including variables such as education, training, experience, age, and marital status. The remaining wage differentials are referred to as the "adjusted" wage gaps.

Since the market might treat the human capital characteristics of different workers differently—such as providing higher returns to education for males than for females—methods (such as the Oaxaca-Blinder decomposition) were developed to attribute that differential treatment to the "unexplained" or "discriminatory" part of the wage gap. An additional refinement to the Oaxaca-Blinder method includes a correction for self-selection: the fact that we do not observe the wages of people who are not in the labor market (Asali 2010).

Other strands of the literature use experimental methods to directly measure discrimination in hiring, for example, by sending fictitious resumes to employers in response to help-wanted advertisements and then comparing the "call-back" rates between the different groups (Bertrand and Mullainathan 2004; Asali et al. 2018).

Discrimination and the macroeconomy

Labor market discrimination studies have mostly been concerned with measuring the extent of discrimination, or unexplained gaps, in labor market outcomes such as wages and employment. Less

attention has been given to the relationship between discrimination in the labor market and the macroeconomic performance of the economy.

Most of the scant studies in this theme have found negative effects of some form of discrimination, in wages, employment, or education, on the economic growth of the country (Klasen and Lamanna 2009; Garcia-Minguez and Sanchez-Losada 2003; Sedgley and Elmslie 2006). An exception to this theme, in which the gender pay gap was positively correlated with economic growth, was found by Seguino (2000). A follow-up study of Schober and Winter-Ebmer (2011), however, found this result to be an idiosyncrasy of the data so that when they were properly used, the effect was found to be negative.

For the most part, these studies focused on gender discrimination, but more importantly, they used cross-sections of countries as data points for their analyses. Clearly, these heterogeneous samples are not justifiably adequate for this type of analysis, mostly because the data from the different countries are aggregated and are not sensibly comparable, as noted by Bandiera and Natraj (2013).

In a rare study of a transition economy, using methods developed in Asali et al. (2017) and Asali (2020), where quarterly time series data from Georgia were analyzed, Asali and Gurashvili (2020) found that both ethnic wage discrimination and gender wage discrimination harm the economic growth of the country. The discrimination-induced misallocation of resources is the stated mechanism behind the negative effect of discrimination on growth. The negative effect of gender wage differentials on growth, moreover, is strikingly much larger in absolute value than the effect of ethnic wage gaps. This is partly explained by the fact that the proportion of female workers is larger than the share of minority workers, and thus, the distortion in resource allocation is accordingly larger. Interestingly, it was also found that periods of high economic growth reduce the extent of ethnic wage discrimination.

Discrimination and unemployment

Lower unemployment rates are linked to tighter labor markets. One of the implications of Becker's theory of discrimination is that in tighter labor markets, discrimination should diminish or vanish. Only a few empirical studies have tested this hypothesis for employment discrimination, and even fewer studies have tested it for wage discrimination.

Studies using experimental methods, like Baert et al. (2015) and Asali et al. (2018), have provided evidence to support this hypothesis for employment; that is, discrimination in hiring is reduced when the labor market is tighter and the unemployment rate is lower.

Using observational survey data, other studies have supported this hypothesis for wages. For example, an increase in unemployment was found to increase the gender wage gap among white workers in the US (Biddle and Hamermes 2013). Similarly, increasing unemployment rates in Georgia were found to be associated with increases in both ethnic and gender discriminatory wage gaps (Asali and Gurashvili 2020).

Targeting ethnic and gender wage differentials

Asali and Gurashvili (2020) observed decreasing ethnic and gender wage gaps in Georgia, yet noticed that the discriminatory part of the wage gap was increasing in the case of gender discrimination but decreasing in the case of ethnic discrimination. Consistent with this evidence is the hypothesis that, in the case of female workers, it is less likely that human capital characteristics account for the gender wage differential. On the other hand, educational gaps and other differences in human capital characteristics between Georgians and non-Georgians are the main reasons behind the observed ethnic wage gap.

Using data from the integrated household surveys of Georgia, from the statistical office of the republic of Georgia, I plot the percentage differences in tertiary education between males and females for Georgians and non-Georgians, as well as the percentage differences in tertiary education between Georgians and non-Georgians for males and females.[2]

[2] The raw data can be found here http://pc-axis.geostat.ge/PXWeb/pxweb/en/Database/?rxid=c767738c-fe00-4f2d-af31-4ec0e7156f65.

Figure1. Percentage difference in tertiary education

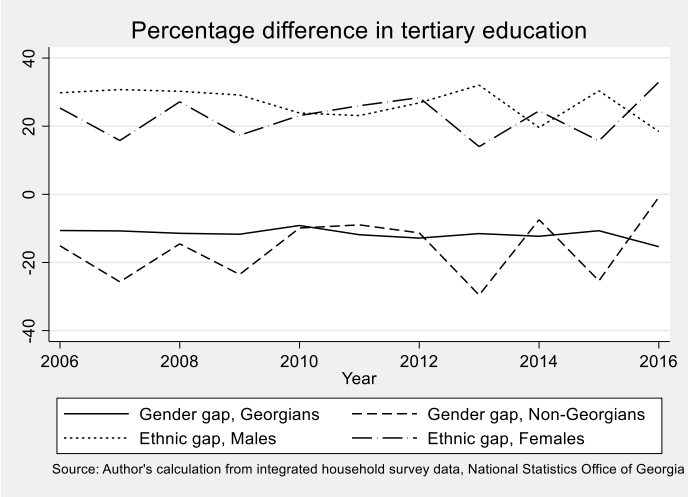

Figure 1 reports the percentage point differences in tertiary education among the different groups: the tertiary education gender gap (male tertiary enrollment minus female tertiary enrollment) among Georgians and among non-Georgians and the tertiary education ethnic gap among males and among females. It is clear that both Georgian and non-Georgian female workers have higher rates of tertiary education than their male counterparts. However, the ethnic gap, that is, the difference in tertiary education between Georgians and non-Georgians, whether males or females, is strikingly high (between 14% and 33%).

Given the well-documented importance of education in determining wages, this is a sign that gaps in higher education, and in human capital characteristics in general, are the likely reason for the observed ethnic wage gap (but not the gender wage gap).

Therefore, this suggests that affirmative action policies are more appropriate to address the gender wage gaps in the labor market: these are policies that directly target and promote female employment and wages. However, in the case of ethnic differentials, policies that address human-capital differentials, such as increasing school enrollment rates, providing general training programs, and possibly providing language and vocational training among minorities, are more suitable.

Limitations and gaps

The evidence considered here is from a single transition country. Therefore, while these findings might readily generalize to other transition, and possibly developing, countries, they are not necessarily

generalizable to other (larger, developed, or non-transition) countries. Hence, more evidence is needed from other countries or settings. In addition, longer spans of data within individual countries are needed for better statistical inference. Additionally, as some studies have shown, in some countries, there are multiple large minority groups, such that different policies might be needed to address the problem of ethnic or racial wage differentials for each racial or ethnic subgroup (Longhi 2020).

Summary and policy advice

Gender and ethnic wage differentials are still persistent phenomena in most countries of the world. Regardless of the background and the reasons giving rise to these differentials, the evidence suggests that at least the unjustified (or the discriminatory) part of the wage differential is not economically harmless. The solid evidence from Georgia (an advanced transition country) supports earlier shreds of evidence that discrimination in the labor market, as manifested in large wage and employment differentials, harms the economic growth of the country. This damage goes beyond the frequently discussed socially detrimental effects of discrimination and inequality (Stiglitz 2012). Suggestive evidence supports a tailored policy to address the different wage differentials. Direct affirmative action policies are preferred for addressing the gender wage gap, while policies promoting the enrichment of human capital are preferred for addressing the ethnic wage gap.

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