

Microeconomics, Module 22, "Wages and Discrimination" (Chapter 16)

*Illustrative Test Questions*

(The attached PDF file has better formatting.)

Question 22.1: Specialized skills

Workers are paid rent for the specialized skills and talents resulting from earlier investments in their lives, and this rent is included in the workers' wages. In this situation, different workers are paid different wages because

- A. They have different amounts of human capital.
- B. They have differing access to capital.
- C. They receive different compensating differentials.
- D. Discrimination is occurring in the labor market.
- E. Workers with more education have higher sunk costs.

Answer 22.1: A

*Question:* This doesn't seem right. I have friends who went to graduate school and earned PhD's in history, classics, and literature. They worked hard for many years, yet not one of them has a good paying job.

*Answer:* Workers are paid rent only for *specialized skills and talents that have use to others*. Businesses don't pay for years of training in classics and history if these skills are useless to them. But if actuarial training is useful to insurance companies, they pay actuaries higher salaries for the specialized skills that they have acquired.

Question 22.2: Compensating differentials

Wages may include compensating differentials because

- A. Workers embody differing amounts of human capital.
- B. A market-oriented policy is needed to compensate for past discrimination.
- C. Some jobs are inherently more risky or unpleasant than other jobs.
- D. Inter-temporal substitution would otherwise cause fluctuations in labor supply.
- E. Longer education or training is needed for some jobs.

Answer 22.2: C

Question 22.3: Discrimination

Suppose employers are indifferent between hiring whites and hiring blacks, but they discriminate against blacks because their white employees have a distaste for associating with blacks. A theory of discrimination based on this premise would predict

- A. Substantial wage differentials between whites and blacks.
- B. A heavily segregated workforce.
- C. Less access to capital for black workers than for white workers.
- D. More pleasant occupations for white workers than for black workers.
- E. Sub-optimal profits for employers.

Answer 22.3: B

*Question:* Landsburg seems to think that employers don't discriminate much in hiring and promotion decisions. But this is not correct. One sees discrimination clearly in third world nations, where people from a different ethnic group are not hired by local businesses.

*Answer:* That is Landsburg's point. Discrimination fails in highly competitive free markets. The best antidote to discrimination is capitalism. Capitalism ensures that only the most efficient firms remain; other firms are forced out of the market. Since discrimination reduces the efficiency of firms, a discriminating firm is forced out of the market.

Landsburg's comments about discrimination apply to other social evils as well. At some universities, one might hear that capitalism is founded on slavery – that American wealth is built on the backs of slaves. This saying has the relation backwards; capitalism is the best antidote to slavery.

- Slavery is most useful for building pyramids by hand labor. One supervisor can oversee a hundred workers and ensure that they do the work requested.
- Slavery works for routine tasks like picking cotton. One supervisor can oversee a dozen workers and ensure that each one picks a full load of cotton.
- Slavery is useless for building laptop computers. A worker who doesn't want to perform the job makes errors in specialized tasks. Laptops built with slave labor don't work.

Landsburg's solution to most social evils is to give free rein to capitalism and free markets. The need for competitive efficiency eliminates most social evils. Free markets by themselves do not always solve social problems. But the general perspective – competitive markets force people to seek economic optimums – has much to recommend it.