The Law and Economics of Racial Discrimination in Employment: The Case for Numerical Standards

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The Civil Rights Act of 1964 marked, and surely contributed to, a dramatic change in the accepted view of racial discrimination. Within a decade after the Act was passed, the consensus in favor of some form of civil rights laws, and against racial discrimination, became virtually beyond challenge in mainstream political debate. In the mid-1950s overt racial discrimination was widespread and often unapologetic; by the mid-1970s anyone who would not publicly condemn racial discrimination was outside the boundary of acceptable political debate.

My subject in this article is whether these dramatic changes in public attitudes and practices ought to cause us to reconsider the purposes of the federal employment discrimination laws. When Title VII of the Civil Rights Act of 1964 was enacted its principal target was the widespread, overt discrimination that existed primarily in the South. That form of discrimination essentially does not exist today. It is difficult to know how prevalent racial discrimination in employment is today; but however widespread it is, it has become mostly covert.

Partly as a result, there is dissatisfaction with Title VII on all sides. Those who believe in vigorous enforcement often complain that Title VII is a cumbersome mechanism that provides inadequate relief. Skeptics argue that Ti-
tle VII imposes pointless costs and distorts employer behavior. In the political arena, skeptics suggest that employment discrimination laws are not an effort to implement a moral vision, but rather the product of the political power of well-organized pressure groups. On the other side, proponents of antidiscrimination legislation appear to lack an overall vision and have become, in a sense, intensely conservative, reacting to each setback by seeking to restore the status quo ante.

In this article, I will try to identify what the purposes of the current generation of employment discrimination laws should be and to suggest institutional arrangements that promote these purposes. I conclude that it is a mistake to focus, as current law primarily does, on the question whether an employer has engaged in specific acts of discrimination. Even if discrimination is the concern in some ultimate sense, the objectives of the antidiscrimination laws are not best served by trying to detect individual acts of discrimination. Instead, the employment discrimination laws should be designed to give employers incentives to hire and promote members of minority groups in proportion to their representation in the relevant population.

In Part I, I outline the principal economic models of employment discrimination, and I discuss the relationship between those economic models and the legal definition of discrimination. In Part II, I give an account of why employment discrimination is wrong. I also discuss why, if we are concerned about justice between racial groups, employment discrimination merits special attention. Why not, for example, ignore employment discrimination and achieve any objectives we might have in this area by simply transferring wealth?

In Part III, I consider the extent to which the operation of competitive markets will eliminate employment discrimination in the absence of employment discrimination laws. I also address the complementary question of what purposes a regulatory regime in this area ought to serve. Finally, in Part IV, I defend my conclusion that these purposes are best served if the law focuses on requiring the employment of sufficient numbers of minorities, rather than on detecting acts of discrimination by employers.


5. For an effort to address this claim, see Ackerman, Beyond Carolene Products, 98 Harv. L. Rev. 713 (1985).

6. For example, the proposed Civil Rights Act of 1991, H.R. 1, 102d Cong., 1st Sess. (1991), is designed to overrule an assortment of recent Supreme Court decisions in the employment discrimination area.
I. LEGAL AND ECONOMIC MODELS OF DISCRIMINATION

Discrimination has to do with treating people differently. Racial discrimination is treating people differently because of their race. Although employment discrimination might refer to more than the actions of employers (for example, it might include the actions of unions, trade associations, and government contracting agencies, all of which have engaged in racial discrimination), for simplicity I will say that racial discrimination in employment occurs when an employer treats employees or applicants for employment differently because of their race.

In this article I am concerned with two questions. They may be thought of as the economic question and the legal question, respectively. First, given the standard assumptions of economic theory, such as the assumption that people rationally promote their own interests, why might employers discriminate? Second, what, if anything, should legal institutions do about employers who discriminate? In this part, I begin with the basic economic explanations of employment discrimination; then I discuss how those explanations fit with the governing legal rules.

A. TWO ECONOMIC MODELS OF DISCRIMINATION

The economic literature offers two basic explanations of why an employer might treat employees differently because of their race. In one model, discrimination results from a “taste for discrimination” that has its origin outside the economic system. This taste is an antipathy to a racial minority group on the part of some relevant economic actor. In the other model, racial discrimination in the workplace is a product of “statistical discrimination.” Statistical discrimination can occur in the absence of any antipathy toward a minority group. Rather, the employer discriminates against a minority group because it is using membership in that group as a proxy for characteristics that are legitimate employment qualifications.

1. Taste-Based Discrimination

According to the taste for discrimination model, either the employer itself or someone whose tastes the employer has an incentive to consider—such as employees or customers—dislikes members of a minority group and does not want to associate with them. The effect of this taste is that the employer incurs an additional cost for employing a minority group member.

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8. For the purpose of this article, I assume that the group that is the object of antipathy is numerically a minority; the analysis changes somewhat if it is not.
If the taste for discrimination is held by the employer, that cost will be the employer's own disutility. If the employer itself lacks any antipathy to minorities, it will still incur an additional cost if its nonminority employees dislike minorities and demand additional wages (or show reduced productivity) when forced to work with minorities. Similarly, the employer will incur an additional cost if customers are less willing to do business with firms that have minority employees.

In each of these circumstances, the effect of the discrimination is to reduce the wages of minority employees compared to those of identical nonminority employees. Under standard economic assumptions, employers are willing to employ an employee at a cost equal to the employee's marginal product. If a relevant actor has a taste for discrimination, the effective cost that the employer must incur for employing a minority employee will be the sum of the money wage and the additional cost to the employer resulting from the taste for discrimination. Consequently, in order to account for the additional costs, a minority employee's money wage will be less than her marginal product.

By contrast, the effective cost of employing a nonminority is simply her wage, so the nonminority employee's wage will equal her marginal product. It follows that, if a relevant actor has a taste for discrimination, a minority employee will receive a lower money wage than an otherwise indistinguishable nonminority employee.

2. Statistical Discrimination

Statistical discrimination can occur in the absence of any taste for discrimination. Statistical discrimination can occur in the absence of any taste for discrimination. A rational employer will discriminate, even if no relevant actor has any discriminatory animus, if the employer concludes that race is a useful proxy for job qualifications.

Discrimination of this form occurs because information about an employee's qualifications is often costly to obtain. Discrimination of this form occurs because information about an employee's qualifications is often costly to obtain. An employer's race, however, is cheaply ascertained. Therefore, if a firm concludes that an employee's race correlates with his or her qualifications, and if better information about the qualifications is too costly to discover, it will be rational, profit-maximizing behavior for the firm to offer lower wages to a minority employee than it would offer to a nonminority employee.

A firm might rationally discriminate in this way even if, so far as the firm has determined, the two employees are identical except for race. In a world of cost-free information, the employer could ascertain each employee's qualifications perfectly. If two employees were found to be identical in every rele-

10. See Phelps, supra note 9, at 659.
11. See Phelps, supra note 9, at 659; Arrow, supra note 9, at 24.
vant respect, it would not be rational to offer them different wages. In the real world, however, information is costly, and the employer will therefore stop trying to ascertain qualifications at some point. At that point, it may be rational for the employer to rely on a surrogate that it knows to be imperfect but that is cheaply ascertained.

B. THE LEGAL DEFINITION OF DISCRIMINATION

Both taste-based discrimination and statistical discrimination are illegal under current law. Although there is controversy over the precise content of the prohibitions of Title VII and other employment discrimination laws, it is undisputed that Title VII forbids an employer from treating a minority employee differently from the way it would have treated an otherwise identical nonminority employee.12 Both taste-based discrimination, of all forms, and statistical discrimination violate that rule.

Discrimination resulting from an employer’s taste for discrimination was probably the principal form of discrimination on the minds of those who drafted and adopted Title VII. But the employment discrimination laws do not permit a defense for any of the other forms of discrimination: there is no “customer preference” or “statistical discrimination” defense. Thus, it is not a defense to a claim of racial discrimination that the employer was taking into account its customers’ response to minority employees, or that the employer was acting on the basis of an accurate generalization about the differences in qualifications between groups. Indeed, all of the various prohibitions against discrimination in American law—those that apply to discrimination by government13 or by recipients of federal funds,14 in public accommodations15 or in housing16—forbid treating members of minority groups differently from otherwise-identical nonminorities. None of these laws allows a defense for the equivalent of co-employee or consumer preference, or for statistical discrimination.

Because they are both illegal, I will treat taste-based discrimination and statistical discrimination as the two basic forms of employment discrimination. I do so even though, in economic terms, taste-based discrimination and statistical discrimination are very different kinds of behavior. Taste-based discrimination is the result of an exogenous preference. Statistical discrimination, by contrast, is the result of imperfect information. As I will discuss below, it would be economically profitable for an employer with a taste for

15. Id. § 2000a et seq.
discrimination to change his or her tastes and stop discriminating even in the absence of employment discrimination laws. But if a firm is engaging in statistical discrimination on the basis of accurate generalizations about real differences between members of groups, it would be unprofitable for the firm to stop discriminating.

Moreover, to the extent that taste-based and statistical discrimination are economically related behavior, arguably other kinds of conduct should be placed in the same category. For example, in economic terms, one way in which taste-based and statistical discrimination are related is that both might produce an earnings gap between minority and nonminority workers even in the absence of any productivity differences between the two populations. Other factors might also produce this effect, however. For example, some groups might, for exogenous reasons, choose less well-paying jobs. Even though the effects on relative earnings are similar to those of taste-based and statistical discrimination, I do not consider this form of behavior (which might be called supply-side statistical discrimination) to be employment discrimination, because the employment discrimination laws are not directly addressed to it.\(^{17}\)

II. Why Is Discrimination Wrong?

One must have some account of what is wrong with discrimination in order to consider what regime of antidiscrimination laws is best. In this section, I will offer arguments for the proposition that taste-based and statistical employment discrimination are objectionable. This approach to the normative basis of the employment discrimination laws is not entirely conventional, and I should explain why I take it. I am not attempting to justify employment discrimination laws (either in general or any particular regime) from first principles. Instead, I am taking as a given the consensus in favor of the basic antidiscrimination principle that both taste-based and statistical employment discrimination are wrong. In this section I try to identify the most plausible bases for this consensus view.

I take this approach, instead of working from first principles, because my objective is to persuade people who accept the existing consensus in favor of civil rights laws that a different set of institutions would better serve the purposes of those laws. Anyone who rejects the existing consensus will not ac-

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cept my argument. But in view of the breadth of the consensus in favor of the basic antidiscrimination principle, persuading the people outside the consensus seems a less important task than suggesting to those who agree with the consensus that there is a better way to accomplish their shared objectives.

A. TASTE-BASED DISCRIMINATION

The judgment that taste-based discrimination is wrong rests primarily on the view that the taste for racial discrimination is illegitimate. That is, no one should be made worse off simply to satisfy someone else's racial animus. The satisfaction of the desire not to associate with members of another racial group, at least in the employment context, should not count in the social welfare function. That desire is comparable to a taste for committing an intentional tort. In determining how the legal system should respond to the intentional tort of battery, for example, we do not consider the utility the tortfeasor gains from the thrill of committing a battery against someone else. The harm to the victim of a battery is all social loss, with no countervailing gain. Discrimination resulting from racial antipathy should be treated in the same way.

It is difficult to construct a justification for this view of taste-based discrimination; it is not clear how one could dissuade someone who genuinely believed that racial antipathy is just another preference, and should be honored to the same extent—just as it would be difficult to dissuade someone who held that view about the taste for committing battery. But the view that racial animus is illegitimate is widespread, almost universal, at least in public discussions. Indeed, the illegitimacy of unapologetic discrimination is one of the most important developments since 1964 that suggests the need to reexamine Title VII. Some people may defend the taste for discrimination so far as private or intimate associations are concerned, but in connection with employment and similar relationships virtually no one argues (in public, at least) that it is acceptable simply not to like associating with members of other racial groups, no matter how virtuous they are. To the extent racial discrimination is defended, it is defended in public as a form of statistical discrimination; the dislike for a group is justified on the ground of other, unquestionably undesirable characteristics that the group supposedly has.

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18. In an earlier draft I said that this judgment rested on the view that the "taste for discrimination is illegitimate." Professors Donohue and Heckman criticized me for claiming that any taste for discrimination, racial or otherwise, is illegitimate. Donohue & Heckman, Evaluating Federal Civil Rights Policy, 79 Geo. L.J. 1713 (1991). I agree with Donohue and Heckman that that claim (whatever it means) is implausible. But I believe it was clear from the start that I am concerned only with racial animus, not with a taste for discriminating on other grounds. I have, in any event, changed this passage to make that limitation more explicit.

Other arguments, including efficiency arguments, have been offered for laws that prohibit taste-based discrimination.\textsuperscript{20} But it seems reasonably clear that the person-on-the-street basis for disapproving taste-based discrimination is that it is unfair to subject minority groups to the consequences of that form of animus. If the taste for discrimination were regarded as just another preference, entitled to the same weight as any taste or desire, it seems unlikely that there would be either employment discrimination laws or the consensus, which appears to exist, that racial discrimination in employment and other contexts is morally wrong.

B. STATISTICAL DISCRIMINATION

Statistical discrimination raises more complex issues. Because statistical discrimination can occur even if no relevant actor has a taste for discrimination, the view that racial antipathy is illegitimate does not explain why statistical discrimination is wrong.

Moreover, any measure prohibiting statistical discrimination imposes costs on society. Suppose the facts are such that a rational firm, lacking any discriminatory animus, would engage in statistical discrimination. If statistical discrimination is prohibited, that firm will have to engage in conduct that is more costly. Either it will spend more resources on ascertaining employees' qualifications, or there will be (more of) a mismatch between employees and jobs. Anyone who wants to prohibit statistical discrimination must justify these additional costs. There appear to be three principal justifications.

1. Inefficient Levels of Investment in Human Capital

Statistical discrimination can lead to inefficiently low investment in human capital among members of the group that is discriminated against. This effect has been widely noted. The intuitive idea is that members of the minority group know that they will be judged not on the basis of their individual qualifications but on the basis of the level of attainment of their group as a whole.\textsuperscript{21} Therefore, no member of the group will capture the full gains from investing in his or her human capital. Each member will capture the gains of such an investment only to the extent that the average level of the entire

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group is increased. In these circumstances, rational members of the group will underinvest in human capital, and society will not benefit fully from their talents.

This is a case in which conduct that is optimal for the firm is not necessarily optimal for society. The reason for the divergence is imperfect information. Of course, it does not follow that statistical discrimination is always socially harmful, all things considered. Eliminating discrimination might impose greater costs on society, on balance, since employers would act less efficiently. But the effect on minorities' human capital investments is a clear, harmful consequence of statistical discrimination.

2. Racial Disparities: The Compensatory Justice Argument

Underinvestment in human capital does not provide the entire explanation of why statistical discrimination is wrong, however. Other employment practices, besides racial discrimination, can bring about underinvestment in human capital. In this respect, statistical racial discrimination is a special case of a more general phenomenon.

Inefficient underinvestment in human capital can occur whenever an employer uses, as a surrogate for productivity, a characteristic that is costly for an individual to alter. While inefficiencies resulting from the use of nonracial characteristics have attracted attention, they are not nearly the focus of concern—especially political, legal, and moral concern—that racial discrimination in employment is. The fact that racial discrimination has attracted so much more attention (including such a prominent regulatory scheme) suggests that there is something about racial discrimination, beyond its tendency to cause inefficiencies, that is troubling. That "something" seems to be the concern that racial discrimination may be the cause of the persistent earnings gap, and of other differences in social and economic status, between ethnic groups—in this society, principally between whites and African Americans.

This concern is the result not of an inherent property of statistical racial discrimination, but of the circumstances in which it is practiced in this society. Statistical racial discrimination will not necessarily lead to differences in the average wages paid to members of majority and minority groups: it might cause a minority group to receive a lower average wage in one industry or job category but a higher average wage in another industry. In theory, the wage differentials might cancel each other out, so that even if statistical discrimination were widespread, there would be no persistent earnings gap between majority and minority groups.

Plainly a major part of the concern with statistical racial discrimination in the United States is that it will not operate in this way, but will instead sys-

tematically burden African Americans. Whether this effect will in fact occur is an empirical question on which there is little helpful information. Empirical studies of the effects of employment discrimination laws on the economic status of African Americans (which are highly inconclusive in any event) are not helpful in assessing the effects of statistical discrimination; such studies reflect the effects of laws that not only reach taste-based discrimination as well as statistical discrimination, and that may impose some costs on the minority population.23 Empirical studies do not, and in principle probably could not, isolate the effects that a precisely-targeted ban on statistical discrimination would have.

In the absence of clear data, it seems most plausible to suppose that statistical discrimination, if it were freely permitted, would have a net negative effect on the economic status of African Americans. It is possible that allowing statistical discrimination would, by increasing efficiency, increase social wealth and ultimately benefit African Americans. But that seems the less likely hypothesis. It would therefore be a mistake to consider how employment discrimination laws should be designed without taking account of the concern that statistical discrimination would systematically burden African Americans.

Why one should be concerned about the racially disparate effects of an employment practice is a complex question. It is commonly said that the purpose of employment discrimination laws is to redistribute income and wealth in favor of African Americans. But such a redistribution is not a self-justifying objective. Some further argument is needed to explain why such a redistribution is desirable. At least two plausible arguments might be offered.

One such argument is essentially a compensatory justice argument. If, in fact, African Americans will be systematically disadvantaged by a rational employment practice, that is at least partly the consequence of actions that were unquestionably wrong. The idea of compensatory justice is that wrongful actions ought to be undone to the extent possible.

More specifically, if race is a good surrogate for productivity, that is because African American employees and applicants lack qualifications, compared to whites. They lack these qualifications at least in part because of discrimination against them (in education, for example) as well as discrimination, often pervasive and virulent, against their ancestors. The precise extent to which such wrongs are responsible for any relative lack of qualifications is impossible to specify. But it is utterly implausible to say that they are not responsible at all.

The compensatory justice argument is that statistical discrimination that cumulatively disadvantages African Americans is objectionable because they would not be less qualified as a group were it not for past wrongs. In a world in which no entitlements had ever been violated, African Americans would not be disadvantaged (at least to the same extent) by statistical discrimination. Statistical discrimination perpetuates past wrongs; one reason to prohibit statistical discrimination is to try to restore people to the position they would have been in were it not for past wrongs.\textsuperscript{24}

This argument raises intertwined philosophical and empirical questions. The idea that justice requires the undoing of wrongs originated in Aristotle,\textsuperscript{25} but it is not universally accepted. In particular, it can be argued that many widely-accepted rules that seem to reflect compensatory justice ideas are actually just ways of creating the incentives needed to deter wrongful conduct and reward worthwhile conduct.\textsuperscript{26} In addition, even if a compensatory justice idea is accepted, it may make a difference how remote in time the wrong was, and whether it was done to the same person who will benefit from the supposed corrective. This in turn raises intractable empirical questions about the effects of current and past discrimination. Two points, however, can be made with some assurance: the compensatory justice idea has strong appeal; and undoubted wrongs are to some extent responsible for the disadvantages suffered by African Americans, disadvantages that statistical discrimination would translate into reduced earnings.

3. Racial Disparities: Racial Stratification and Demoralization Effects

A final reason for concern about the racially differential effects of statistical discrimination is, in a sense, a generalization of the human capital argument. Racial minorities are not, of course, the only groups that suffer cumulative disadvantages from the effects of rational employment practices. To mention the most obvious (perhaps tautological) example, people lacking in talent—defined as the ability to produce that which is valued—suffer cumulative disadvantages from rational employment practices.

Racial distinctions, however, have a special significance in our society. Sometimes social and economic advantages cut across racial lines, so that no group is clearly subordinate to another. It is much more troubling when one social disadvantage after another accumulates on one racial group.\textsuperscript{27} This is

\textsuperscript{24} The logic of this argument leads to a claim for reparations. See generally B. Bittker, The Case for Black Reparations (1973). I discuss below the relationship between these rationales for employment discrimination laws and broader theories of racial justice. See infra Part II.C.


\textsuperscript{26} See, e.g., Epstein, Nuisance Law: Corrective Justice and Its Utilitarian Constraints, 8 J. Legal Studies 49 (1979).

\textsuperscript{27} The classic contrast between ethnic relations in which one group is subordinate and "hor-
especially so when that group has historically most often been victimized by prejudice. There appear to be at least two reasons to find it troubling: it severely demoralizes the members of the group (this is the generalization of the human capital argument); and it is simply unfair to members of the group.

People identify with others with whom they share some connection. This is most obviously true of family members. One takes pride in the accomplishments of family members, and people suffer when family members do not succeed. While these effects are strongest in families, they clearly occur among citizens of the same nation as well. That explains behavior ranging from the nationalistic character of international sports competitions to the willingness of nations, from ancient times, to go to war in the absence of any instrumental reason when a fellow citizen is dishonored.

These effects are felt by members of the same racial group, as well. In theory, it should be possible to measure in some way the demoralizing effects of belonging to a racial group that is subject to cumulative disadvantages. In economic terms, those effects might include not just disutility but reduced productivity, as a result of the loss of a sense that one is (as a member of the disadvantaged group) well regarded in society and that one's efforts have a chance to succeed. In addition to these economic costs, the demoralization effects are unfair because they result from an accident of birth that should not be allowed to affect people in this way.

C. THE EMPLOYMENT MARKET AS A MEANS OF REDISTRIBUTION

These last two arguments—the compensatory justice and racial stratification arguments—speak to more than employment discrimination. Both arguments call for a general transfer of resources to minorities. Describing them as arguments against employment discrimination seems contrived and beside the point; their implications are far broader. Specifically, why would the objectives of compensatory justice and avoiding racial stratification not be better served, at less cost, if the legal system permitted statistical discrimination; captured the efficiency gains (and the gains from reduced administrative costs) through taxation; and transferred the proceeds to African Americans?

There are two answers to this question. The first is in a sense the political counterpart of the theory of the second best. There is a consensus that employment discrimination is wrong. Whatever the concerns about the current employment discrimination laws, the practice of employment discrimination has few defenders. There even appears to be a reasonably strong consensus

zontal relations between groups is presented in Max Weber, Ethnic Segregation and Caste, in FROM MAX WEBER: ESSAYS IN SOCIOLOGY 188-90 (1946).
against statistical discrimination; for example, there has been no legislative effort to incorporate a statistical discrimination defense into Title VII.

By contrast, there is certainly no consensus in favor of the increased use of the tax system to redistribute wealth in favor of minorities. Even if, in principle, such redistributions are a superior way to achieve the objectives of compensatory justice and avoiding racial stratification, they are still not likely to happen. Because of the consensus against employment discrimination, however, there is a chance to achieve these objectives through the employment discrimination laws.

The second answer is related to the first and has to do with the status of employment in our culture. There is a great difference in status in our society between a recipient of a transfer payment and a person who has earned a benefit by being an employee. This is true even if the employee owes her position to government action. If employment discrimination could be prevented, minorities would gain not just additional income, but income earned by being an employee. If one's concern is the status of minority groups in society, that is an important difference.

The idea of "free labor"—that there should not be barriers to people's efforts to sell their labor—is a powerful theme in American history. In different forms, it has been the foundation of several important movements: the antislavery effort; the era of so-called economic due process, in which the Supreme Court invalidated social welfare legislation on the ground that it infringed on freedom of contract; the New Deal era, when the barriers to employment were seen as having been created by private parties and market forces, and the government's role was to overcome them; and the current efforts to eliminate gender discrimination in the law, many of which take the form of enabling women to sell their labor in the market.

The consensus that employment discrimination is wrong draws support from this ideology. That is why, even if the basic objective is to redistribute resources to minority groups, the employment discrimination laws are a preferred vehicle for achieving that goal.

III. COMPETITIVE MARKETS AND DISCRIMINATION

In the previous section I suggested several arguments in favor of laws forbidding racial discrimination in employment. Those arguments by themselves, however, do not establish that any particular set of laws—or any regulatory regime at all—is desirable. There is little doubt that any regime of employment discrimination laws will impose costs on society: the costs of administration; the costs of erroneous determinations; and very likely costs

resulting from distortions in the behavior of employers and employees. The question is whether those costs are worth incurring. If the market will drive out discrimination at less cost, there is no reason to have a regulatory regime.

The effects of competition on employment discrimination are quite complex. Not surprisingly, they depend in part on the kind of employment discrimination involved. In this section, I will canvass the effects of competition on the various forms of discrimination.

A. TASTE-BASED DISCRIMINATION

The following predictions can be made about the ability of each of the three forms of taste-based discrimination to persist in the long run under standard neoclassical economic assumptions:

Discrimination resulting from the employer's animus toward minorities will tend either to be driven out by the market or to have no effect on the wages of minority employees. Discrimination of this kind can survive only if there is some form of imperfection in the market.

Discrimination resulting from co-employees' animus toward minorities is a more complicated matter. In competitive conditions, employees will have an incentive to modify their tastes so that they are no longer hostile to minority employees and thus are able to accept employment at competitive wages. Consequently, there is a long-term tendency for this form of discrimination to disappear. In the short term, certain models hold that this form of discrimination will lead to segregation—one-race firms—without wage differentials between minority and nonminority employees. If certain plausible modifications are made in the assumptions, however, it can be shown that this form of discrimination will lead to wage differentials.

Discrimination resulting from consumer animus toward minorities will not tend to be reduced by competition. Under one set of assumptions, this form of discrimination will not tend to reduce minority employees' wages; under another set, it will. At this time, there does not seem to be either an a priori or an empirical basis for choosing between these competing assumptions.

1. Employer Animus

Consider first discrimination that occurs because of the employer's antipathy to associating with minority employees. Under plausible assumptions, if there is at least one nondiscriminatory firm actually or potentially in the market, discriminatory employers either should be driven out or should have no effect on minority wages. 30

An employer with a taste for discrimination incurs a nonmonetary,  

30. A clear formal demonstration of this can be found in Donohue, Is Title VII Efficient?, supra note 20, at 1415-23.
psychic cost (in addition to the monetary wage cost) whenever it hires a minority employee. So long as that employer hires minority employees, its inputs will cost more than those of a nondiscriminatory employer. To some extent, this higher cost will force down the minority employee’s wages. But unless the supply of minority labor is inelastic, the discriminatory employer will have to absorb some of this additional cost itself. The amount that the minority employee’s wage is lowered will not completely compensate the employer for its psychic cost. Therefore the discriminatory employer’s economic profits will be less than those of a nondiscriminatory employer.

Assuming perfect capital markets, capital should move from the discriminatory firm, with its lower profits, to a nondiscriminatory firm, with higher profits. The employer with a taste for discrimination will therefore receive a better return by selling the firm and making an investment that does not involve coming into contact with minorities. Such an employer should find a willing buyer among potential investors who have no taste for discrimination and therefore can profit more from the formerly discriminatory firm.

Alternatively, an employer with an antipathy toward minorities might choose to avoid the additional psychic cost by hiring only nonminority employees. But unless nonminority employees are perfect substitutes for minority employees, this course will have different costs. That is, minority employees may bring valuable inputs that cannot be obtained from a segregated nonminority workforce. If so, then the firm’s profits will again be impaired. Even if the employer can find nonminority employees who are perfect substitutes for minorities, the refusal of discriminatory employers to hire minorities may force down minority wages. This will make cheaper labor available for nondiscriminatory employers. By providing its nondiscriminatory competitors with a cheaper labor supply, the discriminator will again be at a competitive disadvantage.

Finally, it is possible that a discriminatory employer’s refusal to hire minorities will neither deprive the employer of valuable complementarities nor affect minority wages. This will happen if the discriminatory employers are few in number and nonminority employees are perfect substitutes for minorities. The discriminatory employers can hire nonminorities without suffering, and because the number of discriminatory employers is so small, the level of minority wages is not affected. In this case, employers with a taste for discrimination could remain in business, but minority wages would not be af-

31. See id.
32. A competing theory argues that employer discrimination can persist in the market if it is motivated not by animus against minorities but by favoritism toward nonminority employees. See generally Goldberg, Discrimination, Nepotism, and Long-Run Wage Differentials, 97 Q.J. Econ. 307 (1982). However, Goldberg’s basic assumption that favoritism is the source of labor market discrimination is implausible as a large scale explanation. See Donohue, Is Title VII Efficient?, supra note 20, at 1422 n.31.
fected. There would still be employment discrimination in the legal sense, but the discrimination would not cause minorities to suffer economically.

Given competitive conditions and standard assumptions, therefore, discrimination against minority employees that has its origin in employers' antipathy will not persist in a harmful form. If there are competitive imperfections, such as monopoly, then discrimination might persist. Of course, discrimination might also persist if the government or quasi-governmental forces—such as private violence—enforce it.

It follows that regulation should serve two purposes in addressing this form of discrimination. First, regulation should seek to remove any factors that prevent the antidiscriminatory aspects of the market from operating. Monopoly is one such factor, but since that is the principal concern of the antitrust laws it is of limited importance for the employment discrimination laws. (I continue to leave aside actions by unions, which raise additional issues.) Private forces that use violence and ostracism to prevent minority hiring are another such factor. Although laws restricting the hiring of minorities have been unconstitutional and therefore unenforceable in court since the Supreme Court decision in Brown v. Board of Education,\(^3\) social customs that threatened employers who hire minorities survived Brown and may persist today in some places. A regulatory regime can counteract such forces in several ways: by imposing countervailing incentives; by serving as a means by which employers who do not wish to discriminate can coordinate their refusal, thus overcoming a collective action problem; or simply by enabling employers to deflect social hostility by saying that the decision to stop discriminating was not their idea.\(^4\)

The second purpose of a regulatory regime in this context should be to accelerate the tendency of the competitive market to drive out this form of discrimination. There is a debate over whether it is efficient to accelerate this tendency.\(^5\) I am proceeding, however, from the premise that employer-animus discrimination is objectionable because the taste for discrimination is illegitimate. Given that assumption, there is no question that the demise of this form of discrimination should be accelerated, other things equal.

34. For example, federal antidiscrimination measures had a dramatic effect on the employment of African Americans in the South Carolina textile industry. These effects were not brought about by a variety of market conditions before 1965. Heckman & Payner, Determining the Impact of Federal Antidiscrimination Policy on the Economic Status of Blacks: A Study of South Carolina, 79 AM. ECON. REV. 138, 173-74 (1989).
35. See Donohue, Is Title VII Efficient?, supra note 20, at 1426 (accelerating tendency of market is efficient); Posner, supra note 4, at 514 (criticizing Donohue for overlooking effect of transaction costs); Donohue, Further Thoughts, supra note 20.
2. Co-Employee Animus

The effect of competition on discrimination is different if the taste for discrimination is held not by the employer but by nonminority employees. Becker's model predicts that the long-run effect in this case will be segregated firms with no wage differential between minority and nonminority employees.\(^{36}\) Although that is a nondiscriminatory equilibrium in a certain sense, it is not a desirable state of affairs. Moreover, Arrow and others have shown that integrated firms with wage differentials (relative to marginal product) can occur in the long run in competitive conditions when co-employee animus is present.\(^{37}\) Finally, while there should be some tendency for this form of discrimination to diminish over time in competitive conditions, information costs may make this kind of discrimination quite durable.

\(36.\) G. BECKER, supra note 7, at 56.

\(37.\) See Arrow, supra note 9; Akerlof, infra note 46.

\(38.\) G. BECKER, supra note 7, at 56.

\(39.\) See id.

\(40.\) Note that this is different from the situation described just above, in which a few employers who have a taste for discrimination might continue in business in the long run, so long as they have no effect on minority wages. In that situation, those few firms are all nonminority, but the vast majority of firms are operated by nondiscriminatory employers and are therefore integrated. In the equilibrium predicted by the Becker model, no firm is integrated.
tial disparities in wealth and income between minority and nonminority con-
sumers, the minority firms will become less profitable. There will still be no
discrimination in the limited sense that both minority and nonminority em-
ployees will receive their marginal products. But it is hardly desirable to
bring about a long-term equilibrium in which minority employees can find
jobs only in all-minority firms where wages are lower because only the poorer
minority population will patronize them.

b. In any event, under certain plausible conditions co-employee animus can
lead to integrated workforces with discrimination in wages.\textsuperscript{41} Suppose that
minority and nonminority employees are not perfect substitutes, so that an
employer can gain from complementarities that are available only if it hires
an integrated workforce. Suppose further that those additional gains exceed
the premium that must be paid to nonminority employees to compensate
them for their dislike of working with minorities. The result under these
conditions will be an integrated workforce with wage discrimination.

Alternatively, suppose that minority wages are depressed below marginal
product by some other factor, such as a form of statistical discrimination or
employer-animus discrimination that has persisted. A previously all-nonmi-
nority firm may then find it profitable to hire minority employees. Specifi-
cally, it will hire minority employees if the rents it gains from underpaying
them exceed the premium it must pay its prejudiced nonminority employees.

The Becker model predicts that in such circumstances a firm will simply
fire its nonminority employees and become a segregated minority firm.\textsuperscript{42} It
can then take full advantage of the rents it earns on minority employees,
without paying any premium to discriminatory nonminority employees. But
typically firms make investments in employees, such as on-the-job training.
If the discounted cost of those investments exceeds the premium that must be
paid to the nonminority employees, the employer will not fire all the nonmi-
nority employees; it will prefer to pay them the premium instead of investing
in new employees. Therefore, it will be rational for the firm to integrate and
engage in wage discrimination.\textsuperscript{43}

Thus, under competitive conditions and plausible assumptions, discrimina-
tion resulting from co-employees' animus could lead to one of two undesir-
able states of affairs—either segregation or wage discrimination.

c. There should, however, be a long-run tendency for competition to drive
out this form of discrimination as well. Employees with a taste for discrimi-
nation make it more costly for an employer to hire an integrated workforce.

\textsuperscript{41} G. Becker, supra note 7, at 58; Arrow, supra note 9, at 6, 10-13.
\textsuperscript{42} G. Becker, supra note 7, at 60.
\textsuperscript{43} See Arrow, supra note 9, at 95-96.
An employer who must use a segregated workforce may lose out on some complementarities or valuable inputs, or may incur greater search costs.

As a result, employees with discriminatory animus are less desirable to employers than those who lack such a taste. Employees and potential employees therefore have an incentive either to change their tastes or to suppress the expression of their tastes. In the long run, this effect should drive out discrimination based on co-employee animus.

Nonetheless, information costs might cause this form of discrimination to persist for a long time even in competitive conditions. Suppose an employer finds that the productivity of a certain working unit declines when a minority employee replaces a nonminority employee who did not appear to be different in qualifications. It might be too costly for the employer to ascertain the exact cause of this decline. For example, it might be impossible for the employer to discover (at acceptable cost) whether the decline in productivity is the result of racial animus (in which case the solution might be to fire the discriminatory co-employees) or of some personality quirk of the minority employee (in which case it might be rational to fire the minority employee). Indeed, it is often difficult even introspectively to know for certain whether one is responding simply to a personality trait or to a characteristic like race.

Especially when minority employees are integrating into previously all-nonminority firms, the employer’s tendency in this situation will be to view the new minority employee, in which the employer has not made a substantial investment, as expendable. Ultimately, if the nonminority co-employees have a taste for discrimination, the employer will find it unprofitable to continue to employ them. But that may be in the very long run. There is a favorable long-term tendency, but discrimination of this kind is likely to prove durable.

Here again the objective of regulation should be to accelerate the operation of the market—in this case, the tendency of the market to induce discriminatory employees to change their tastes. In this context, however, regulation will accomplish this not by enhancing competition but by doing the opposite: by effectively establishing a cartel among employers so that they do not bid for discriminatory employees. If employers are somehow prevented from allowing co-employees' animus to justify discrimination against minority employees, they will neither operate segregated firms (since that would involve discrimination in hiring) nor engage in wage discrimination. They will, of course, incur additional costs; discriminatory co-employees will extract their premium in the form of reduced productivity. But since employers will not be able to pass this cost on to minority employees, the result will be to give employers a greater incentive to avoid hiring nonminority employees with a taste for discrimination. That in turn will give those employees an incentive to change their (revealed) preferences.
3. Consumer Animus

In many important markets—retailing and the professions, for example—the origin of goods and services can be easily identified, and consumers with a taste for discrimination will offer less for services from firms that employ minorities.\(^4\)

There are two competing models of consumer taste-based discrimination, and it is difficult to choose between them. In Becker's model, so long as there are a sufficient number of either nondiscriminatory consumers or consumers who discriminate in favor of minorities, consumer animus towards minorities will not result in wage differentials.\(^4\) This model may still, however, yield an undesirable separate but equal situation similar to that which can result from co-employees' animus. In Akerlof's competing model, which assumes that trading opportunities will be costly, discrimination can persist even if there are a large number of nondiscriminatory consumers.\(^6\)

\(a\). In the Becker model, so long as there are a sufficient number of nondiscriminatory consumers, all nondiscriminatory firms will be able to sell without incurring additional costs.\(^7\) The nondiscriminatory consumers will be the ones who "make the market"—just as, in the case in which employers have a taste for discrimination, it is the nondiscriminatory employers who "make the market" for minority employees, thus forcing a long-term nondiscriminatory equilibrium.

Even if there are not a sufficient number of nondiscriminatory consumers, wage discrimination will not result if there are enough consumers who discriminate in favor of all-minority firms. As in the case of co-employee animus, however, this will tend to produce segregated firms. There will be, in effect, two markets: nonminority-produced widgets, and minority-produced widgets. Depending on the strength of the taste for discrimination, the two may be poor substitutes. But if a sufficient number of consumers have a prominority taste for discrimination, then minority employees' wages will not be affected even if all firms are segregated. In that sense, there will be a nondiscriminatory equilibrium.

As in the case of co-employees animus, this separate but equal state of affairs is surely undesirable. In this equilibrium there could be, for example, "white Protestant," "African American," and "Jewish" law firms and retail establishments that employ only members of those groups and cater only to members of those groups. There is plenty of anecdotal evidence, and some

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44. G. BECKER, supra note 7, at 93.
45. Id. at 75-77, 93-95.
47. G. BECKER, supra note 7, at 43-44, 158-59.
more systematic evidence, that such a division of the market existed in the past and still persists to a degree. Even if there are no discriminatory wage differentials in the economic sense, this kind of arrangement contributes to racial and ethnic stratification.

b. In addition, Akerlof has shown that if trading opportunities are costly, Becker's prediction does not hold.\(^48\) In such circumstances, the presence of a substantial number of discriminatory consumers will reduce minorities' wages even if there are many nondiscriminatory consumers as well.\(^49\)

The argument is as follows: The Becker model depends on the ability of nondiscriminatory firms to seek out nondiscriminatory customers at no cost. But suppose that trading opportunities are not freely available but instead occur as a result of costly searches or random contacts. In these circumstances, the loss of a current or potential trading partner is costly.

So long as there are some discriminatory customers in the market, a firm must consider the possibility that a current or potential trading partner has a taste for discrimination. As long as that possibility exists, the firm runs the risk of a costly loss of a trading partner if it hires a minority employee. The risk of losing a trading partner for this reason translates into an expected cost—a cost that is incurred if the firm employs minorities (or employs minorities in numbers or positions inconsistent with the social custom that is "enforced" by the discriminatory consumers).

In summary, discriminatory tastes held by consumers can bring about, as a long-term competitive equilibrium, either a segregated market in which wages are equal or wage discrimination against minority employees. Consequently, the objective of a regulatory regime in connection with this form of discrimination is again anticompetitive: it is to prevent firms from competing for the patronage of discriminatory consumers.

B. STATISTICAL DISCRIMINATION

Not surprisingly, the effect of competition on statistical discrimination depends on whether there are actual differences in productivity between the minority and nonminority populations.

1. Actual Differences in Productivity Between Groups

It is easy to see how statistical discrimination—that is, the use of race as a proxy for characteristics related to productivity—can persist if there are actual differences in productivity between groups. The employer's use of the

\(^{48}\) Akerlof, supra note 46, at 266.

\(^{49}\) Id.
racial generalization will be confirmed by employee productivity. Two points, however, should be noted.

First, even in this situation, statistical discrimination will tend to be used less over time in competitive conditions. That is because, speaking roughly, the value of race as a proxy is its cheapness, not its accuracy. Because of the range of productivity within racial groups, race or ethnicity is a crude proxy. Accordingly, there will be pressure on employers to use characteristics that are more reliably correlated with an individual's productivity. Over time, as the technology of measuring employee skills advances, and better proxies become cheaper to use, statistical discrimination should erode.

Second, although statistical discrimination may persist if there are actual productivity differences, those differences may not be exogenous. This is the import of the human capital argument. Statistical discrimination encourages minorities to underinvest in human capital, which in turn makes statistical discrimination rational. There is a vicious circle: the differences that make employment discrimination rational may themselves be the products of employment discrimination.

2. No Productivity Differences

In the long run, statistical discrimination should not persist under competitive conditions if there are no actual differences in the productivity of the groups involved. If an employer is using an inaccurate generalization about minority employees in making employment decisions, it has an incentive to correct its assumptions. If it does not, there is an opportunity for an employer who is not using such a generalization to seize a competitive advantage.

The important questions, therefore, are the following. First, if there are no productivity differences between groups, under what circumstances is statistical discrimination likely to occur? Because statistical discrimination is not based on any animus toward the minority group, it is not obvious why it would occur at all unless it was based on actual differences between groups. The answer, as I will discuss shortly, is that "erroneous" statistical discrimination can occur when information about minority employees is unreliable.

Second, if erroneous statistical discrimination does occur, what kinds of developments are likely to speed its eradication, given that in the long term it should not persist? This question is important because of the vicious circle of underinvestment in human capital. Erroneous statistical discrimination, like all statistical discrimination, will cause members of minority groups to underinvest in human capital. That, in turn, really will make minority employees less productive. Long-term market forces will then not eliminate the discrimination. A short-term problem of erroneous discrimination against
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minorities will have been transformed into both long-term discrimination and an overall loss of productivity to society.

a. Erroneous statistical discrimination can occur if the information employers have about minority employees and applicants is less reliable than the information they have about nonminorities. This probably happens often. Employment tests may be geared to nonminorities and not measure potential minority employees' abilities with the same degree of reliability. Potential minority employees may go to inferior schools whose grades and other methods of evaluation are less reliable. (This is different from saying that potential minority employees may have inferior educations; that would cause actual productivity differences between groups.) In occupations in which subjective evaluations are important, a nonminority employer may be less confident of his or her ability to "size up" a potential minority employee by evaluating characteristics that cannot be objectively measured. Potential minority employees also may not have as good a network of contacts that can convey reliable information about them to prospective employers.

Unreliable information can lead to discrimination in several ways. First, employers who lack reliable information may resort to traditional stereotypes and simply assume that minority employees are less productive. This assumption need not be the result of animus; an unprejudiced employer might believe that minorities are less productive because, for example, they have generally received inferior educations and have been discriminated against in other areas. Even if that assumption is incorrect, or overstated, the employer may act on it (in the short term) in the absence of more reliable information.

Second, an employer lacking reliable information about minorities may engage in discrimination if it is risk averse (and unable to insure against the relevant risk). If information about minorities is less reliable than information about nonminorities, it will be more risky—and therefore, to a risk averse employer, more costly—to hire minorities. Such an employer will either not hire minority employees or pay them less than nonminorities.

I regard discrimination of these forms as statistical discrimination, even if the basis of the employer's assumption that minorities are less well qualified is an unsupported stereotype. That is because discrimination of this kind is based on a factual belief that is subject to falsification. If the employer learns enough about minority employees to show that the assumption is untrue, the employer will abandon the assumption. If the employer does not abandon the assumption even after it learns that the assumption is false, then the employer is engaging in taste-based, not statistical, discrimination, and a different analysis is appropriate.

b. It follows that statistical discrimination can be reduced if employers are provided with reliable information about employees. This should be a princi-
pal objective of any regulatory regime in this area. Ordinarily, one excellent way to learn about an employee's qualifications is to hire him or her. The employee's actual productivity is likely to become more apparent over time. Employers who "sample" minority employees by hiring them will therefore often gain reliable information about them. That information will, if employers are free of racial animus, displace the assumptions they have made about minority employees.

Employment discrimination laws are not the only means by which employers might be induced to sample minority employees. The business cycle may also have this effect. If labor markets are slack, there will be little pressure on an employer to hire minority employees. An employer who begins with the assumption that minority employees tend to be less productive may succeed for a time in excluding or underpaying minority employees even if that assumption is wrong. But if labor markets are tight, the employer will have no choice but to hire minorities. The employer's experience with those employees will then prompt the employer to reevaluate its assumptions.

c. Erroneous statistical discrimination may, however, persist even after minority employees are hired in large numbers. Often the best source of reliable information about a potential employee is that person's current employer. This is especially likely to be true in the case of minority employees because other sources of information about them—test scores, informal references, school grades—are often unreliable for the reasons I mentioned above.

One way in which an employer signals an employee's ability is by paying a higher wage or promoting the employee. But if other sources of information about an employee are unreliable, the current employer has an incentive to conceal its knowledge that the employee is productive. Promoting the employee or paying a higher wage would only provide competing employers with information that might prompt them to make an offer to the employee. By underpaying the minority employee, the employer can collect a rent and at the same time make it less likely that the employee will be lured away.

Ordinarily the employee's recourse in this situation is to seek a counteroffer from another employer. But if information about minority employees tends to be unreliable, or is thought by employers to be unreliable, minority employees will not be in a position to do that. The unreliable information about the employee, coupled with the negative "signal" from the current employer, will dissuade other employers from making competing offers.

As a result, the minority employee may remain locked into a job with a discriminatorily low wage. Again, the culprit is not necessarily prejudice; all of the employers' actions can be ascribed to self-interest, without any racial

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animus. So long as information about minority employees is unreliable, employers have an incentive to discriminate against them in wages and promotions. The culprit is unreliable information about minority employees.

In the long run, enough competing employers may be forced to "sample" minority employees to break up the discriminatory pattern. But the pattern may persist for some time unless that happens. In addition, it is even more likely that this type of discrimination will result in underinvestment in human capital by minorities. In the usual case of discrimination, the assumption is that a minority employee will perceive that there is discrimination in society and will respond by underinvesting in human capital. There is a chance, however, that the minority employee may not be well attuned to the level of discrimination in society as a whole and therefore may not respond in this way. But a minority employee is likely to notice being underpaid by his or her employer, and to perceive that any gains resulting from investments in human capital will be captured by the employer. This makes underinvestment even more likely.

It is difficult to draw any simple conclusions about the effects of competitive markets on discrimination. It is clear that regulation has an extremely important role to play. That role varies depending on the nature of the discrimination. Accurate statistical discrimination and customer animus discrimination are resistant to competitive pressures. Other types of discrimination, such as co-employee animus discrimination and inaccurate statistical discrimination, are less resistant. Employer animus discrimination is the most likely to succumb to competitive pressures, although even in that context it is a mistake to conclude that the market will necessarily solve the problem and regulation has no role to play.

IV. THE CASE FOR A DISPARATE IMPACT APPROACH

The remaining problem is to determine the institutional arrangements that will best promote the objectives that employment discrimination laws should serve. This task has several parts. The first is to identify the institutional options that are available for combatting discrimination. The second is to assess the extent to which these alternative arrangements carry out the purposes of antidiscrimination regulation. The third is to try to have some sense of the costs that the different alternatives will impose. Finally, I will venture some brief thoughts on how, specifically, a new scheme of employment discrimination laws might be designed.

There are two basic approaches that a system of employment discrimination laws might take. The first basic approach is the disparate treatment approach. Under this approach, the objective is to determine whether an

employer is guilty of specific acts of discrimination.

The second approach does not seek to determine whether an employer has engaged in acts of discrimination but instead focuses on the number of minority employees the employer has hired and promoted in each job category. If those numbers are not proportionate to the number of minorities in some relevant population, then the employer is at least prima facie liable. I will call this the disparate impact approach, because one version of this approach (although a much more refined and limited version than what I just described) is the controversial disparate impact standard of Title VII.52

My argument is that the purposes of the employment discrimination laws would be best served by moving the focus away from—perhaps all but abandoning—the disparate treatment approach. Instead, the focus of enforcement should be a strict disparate impact approach. The disparate treatment approach, which was well suited to the kind of overt discrimination that existed when Title VII was enacted, is today both an ineffective and a costly method of achieving the objectives of the employment discrimination laws. Those objectives can be better promoted, probably at less overall cost, by seeking to induce employers to hire, promote, and compensate minority employees in proportion to their numbers in the relevant population.

A. DISPARATE TREATMENT

There are two principal problems with the disparate treatment approach to employment discrimination. First, it is very difficult to ferret out acts of covert discrimination, and covert discrimination is the form that employment discrimination is most likely to take today. Consequently, the likelihood of error under this standard is high, and the costs of administering it are likely to be great. The second problem is that the disparate treatment approach will be least successful at combatting the kinds of discrimination that are most likely to persist in a competitive system. The disparate treatment standard is most effective at duplicating the work that the market is likely to do anyway, and least effective at doing the antidiscrimination work that the market cannot do.

1. The Likelihood of Error

In a world of overt refusals to hire minorities, dual wage scales, and explicitly segregated job categories, all of which existed in 1964, the disparate treatment standard can do much good work. It can be enforced against overt discrimination with relatively low administrative costs and little likelihood of

error. If it is effectively enforced, however, employers will soon stop discriminating overtly.

Today, predictably, employers have long since adjusted to the existence of Title VII. Few are foolish enough to discriminate overtly, at least on a large scale, and if they do discriminate they cover their tracks. This makes it even more difficult to prove discrimination in court. The administrative costs of enforcing a disparate treatment standard are increased because more detailed testimony is needed if hidden discrimination is to be uncovered. And the likelihood of errors—usually false negatives if the burden of proof rests on the claimant—is great.

The costs of such a system are further increased because there is some tendency for plaintiffs in discrimination litigation to be borderline employees. The kind of employment action most likely to lead to discrimination litigation is a discharge. This is true for a number of reasons: a discharged employee is likely to feel more deprived than an employee who has not been hired, promoted, or given a higher wage; a discharged employee has no continuing relationship with the employer; and a discharged employee is more likely than a rejected applicant to compare himself to other employees and conclude that the employer has discriminated.

Even a discriminating employer will be less likely to discharge a superior minority employee. Not only is that economically irrational, but so long as it is generally considered unacceptable to discriminate, an employer will not want to make it obvious that it is engaged in discrimination. Indeed, it is possible that even many discriminatory employers value able minority employees because the employer can point to them as evidence that it does not discriminate.

Consequently, a disproportionate number of employment discrimination cases will be brought by employees whose status is marginal anyway—that is, employees whom the employer had some, although perhaps not sufficient, legitimate reason to discharge. It will be much harder—more costly, with a greater likelihood of error—to disprove an employer’s contention that the action it took against such a borderline employee was based on a legitimate reason.

53. In the draft presented at the conference, I stated this point more unequivocally. The comments of Professors Becker and Clark have persuaded me that this is at most a tendency that should not be overstated, and that the tendency will be reduced if, as I propose, there is less enforcement of the disparate treatment approach. Becker, supra note 17; Clark, The Law and Economics of Racial Discrimination in Employment by David A. Strauss, 79 GEO. L.J. 1695, 1695-96 (1991).


55. See Posner, supra note 4, at 518 ("Even a bigoted employer is unlikely to take out his racial animus against a perfect worker. Most workers are not perfect. As to them, it is usually easy to supply a plausible reason why they were not hired or why they were let go.").
Anecdotal evidence suggests what these factors predict. Title VII disparate treatment trials, especially those involving single plaintiffs, are often long (two- or three-day), detailed inquiries into the qualifications of a borderline employee to decide whether the employee was fired for one of the legitimate reasons that existed or for discriminatory reasons, which might also have existed. At the end of the process, it is difficult to have much confidence in the outcome. It is hard to see how a process this cumbersome, and this unreliable, with such a small payoff, is worth the candle—or is going to promote the objectives of employment discrimination law.

2. The Failure to Complement Market Forces

The second problem with the disparate treatment standard is that it is the least likely method to detect those forms of discrimination that are most likely to persist in the long run under competition—accurate statistical discrimination, consumer animus discrimination, and to a lesser extent co-employee animus and inaccurate statistical discrimination. Assuming discrimination has occurred, the victim will have the best chance of proving it if the discrimination resulted from the employer’s taste for discrimination and the worst chance of proving it if the discrimination resulted from co-employee or customer antipathy. But employer-animus discrimination is the kind of discrimination least likely to persist under competitive conditions. Thus the disparate treatment standard helps the market eliminate discrimination in the instances in which the market least needs help.

When discrimination occurs as a result of the employer’s animus, there will be no difference in what might be called market productivity between the minority and nonminority employees. By market productivity, I mean the production of goods and services that are exchanged in the market. In the case of employer-animus discrimination, minority employees are less productive only in the sense that they cause disutility to the employer. That disutility will not be reflected in any standard measurement of productivity.

This gives the minority employee some chance to prove discrimination. The minority employee will try to show that the employer would not have taken an adverse action against a nonminority employee who was equally productive. A claimant might be able to make that showing either by detailed comparison with similar nonminority employees or, if the sample is large and the employer is a consistent discriminator, by statistical analysis. Although this will be a costly and error-prone process—especially if there is a tendency for claimants to be borderline employees—at least there is a chance of reaching the right decision.

Other forms of taste-based discrimination, however, will be nearly impos-

56. See Posner, supra note 4, at 514.
sible to prove using the disparate treatment standard. Discrimination resulting from co-employee animus or consumer animus, unlike discrimination resulting from employer animus, will be reflected in market productivity differences. The minority salesperson will do less business; the minority lawyer will not attract clients; the productivity of a group of employees will drop when a minority employee replaces a nonminority employee. In these situations, an employer can justify its adverse action against the minority employee by pointing to these productivity differences.

It will generally be very difficult for a finder of fact to ascertain whether these differences in productivity between minority and nonminority employees are the result of prejudice. Co-employees have an incentive to conceal any taste for discrimination, because that taste can only make them less attractive to employers. Moreover, it is often difficult, even introspectively, to distinguish discriminatory animus from legitimate reasons for not wanting to work with someone. In most contexts discrimination is sufficiently unrespectable to cause both customers and co-employees to conceal their animus sufficiently to make it very difficult to prove.

As a result, even the employer will often not know whether a minority employee's reduced productivity is the result of discrimination by co-employees or customers. Even a court that could administer a foolproof lie detector test to the employer could often not detect whether a discriminatory taste (by co-employees or customers) underlay the employer's action. It seems only a slight overstatement to say that once discrimination has become covert, using the disparate treatment standard to combat these forms of discrimination is essentially a hopeless task. But these are the kinds of taste-based discrimination that are most likely to persist in competitive conditions.

3. Statistical Discrimination

Applying the disparate treatment standard to statistical discrimination raises a different set of problems. One problem, however, is the same: because statistical discrimination is unlawful, it is likely to be covert and concealed. The problems and costs of proof will, therefore, again be great.

Also, statistical discrimination is most likely to occur in hiring because information about employees is ordinarily much easier to acquire than information about applicants, and it is a lack of information that makes statistical discrimination rational. For reasons I have stated, a failure to hire is less likely to lead to litigation than a discharge. Consequently, enforcing a disparate treatment standard is not likely to have much effect on the incidence of statistical discrimination.

The real difficulty with using a disparate treatment standard to combat statistical discrimination, however, lies elsewhere. The reasons for seeking to eliminate statistical discrimination are different from the reasons for seeking
to eliminate taste-based discrimination. Taste-based racial discrimination is objectionable principally because no individual should suffer a loss in order to satisfy someone's taste for racial discrimination. Accordingly, it makes sense to try to prevent or redress each instance in which an individual suffers a loss for this reason.

Statistical discrimination is objectionable for quite different reasons. It is not the fate of the individual victim of discrimination that makes statistical discrimination troubling. Whether a particular minority employee is subject to statistical discrimination depends entirely on a fortuity—whether other cheap sources of information about that employee are available. Rather, what makes statistical discrimination troubling is the aggregate effects of statistical discrimination on the minority population—the fact that it discourages investment in human capital, perpetuates wrongs done against minorities, and subordinates them as a group. In order to deal with these effects it is not necessary to redress individual instances of discrimination; it is only necessary to avert the harmful aggregate effects. The disparate treatment standard is a roundabout and wasteful way of doing this, because it insists on proof of specific acts of discrimination. A disparate impact approach, which focuses on the aggregate level of minority employment and compensation, is a more direct and less costly way of preventing the harmful aggregate effects.

B. DISPARATE IMPACT

I will consider the following version of the disparate impact approach: an employer's practices (hiring, promotion, and compensation) must benefit minority employees according to their proportions in the relevant labor pool, unless the employer can show that it would be very costly to do so. Obviously some of the key terms must ultimately be specified—such as the relevant labor pool and the requirements of the cost defense—but this definition will suffice for now. This definition roughly corresponds to the disparate impact standard that was used under Title VII.57

My argument is that this standard is superior to the disparate treatment approach. It is impossible to make any fully conclusive arguments without better data than are (or may ever be) available. But to the extent that we are able to make a judgment now, the disparate impact approach seems superior.

1. Taste-Based Discrimination

In a perfect world, the disparate treatment standard would identify all instances in which a person was suffering a loss because of another's discriminatory animus—the objective of antidiscrimination law in this area. But the

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theory of the second best may operate here: because the disparate treatment standard works so imperfectly in a world of covert discrimination, there is a good argument that the disparate impact approach is superior.

Whether this argument is ultimately correct depends on two things that are very difficult to specify: the incidence of taste-based discrimination and the value we attach to eliminating it. The higher the incidence and the more important its elimination, the greater the likelihood that the disparate impact standard is superior. We now have some evidence on the incidence of racial discrimination in employment. Assigning a value to its elimination will necessarily be a controversial matter, and we have no reliable way to measure the other relevant variables, such as the costs of the alternative regimes. But the case for the superiority of the disparate impact approach appears strong.

Assuming that discrimination is covert, the disparate treatment standard has only a weak tendency to identify those cases in which discrimination has occurred. That is, the disparate treatment approach will generate a high ratio of false negatives. As I have said, in the case of employer-animus discrimination, the disparate treatment approach will detect discrimination only when the victim can demonstrate that he or she was as productive as some nonminority employee. In connection with other kinds of taste-based discrimination, the disparate treatment approach is, in general, simply unable to identify cases of discrimination.

The disparate impact approach, crude as it is, seems superior to the disparate treatment standard. Cases in which an employer has disadvantaged a disproportionate number of minority employees are more likely to involve taste-based discrimination than a random sample of cases. Cases in which the employer has done so without a strong cost justification are more likely still to reflect discrimination (since it is less likely that the employer is acting for pecuniary reasons). Obviously there will be a large number of false positives in applying the disparate impact approach. But recall that in a world of covert discrimination, false negatives will be legion under the disparate treatment standard. It is difficult to compare false negatives to false positives—that would require assigning a value to eliminating this form of discrimination—but unless discrimination is quite uncommon, there is no sufficient reason to conclude that the disparate treatment approach should be adopted.

In addition, the disparate impact approach has the clear advantage of minimizing the costs of whatever errors do occur. The cost defense will prevent very costly false positives. By contrast, the disparate treatment approach

58. A recently completed study by the Urban Institute—the only study of which I am aware that used testers—found that, in the two cities studied (Chicago and Washington), 20% of employers discriminated against blacks in processing job applications. Turner, Fix, & Struyk, The Urban Institute Employment Discrimination Study: Summary of Findings 2 (May, 1991) (copy on file at The Georgetown Law Journal).
does not have a built-in means of limiting errors—either false positives or false negatives—to those that are least costly.

For similar reasons, the disparate impact approach seems likely to reduce the distortions that the regulatory regime will create for employers. Again, the direction of the effects is much clearer than the magnitude, and it is difficult to make a judgment without data. But under the disparate impact approach, an employer can make whatever employment decisions it wishes within the minority employee population, so long as it maintains the required ratios (or justifies its failure to do so). Subject to that constraint, it is free to reduce the wages of, or discharge, minority employees.

The disparate treatment approach does not give an employer that latitude. Under the current regulatory regime, whenever an employer takes an adverse action against a minority employee it must fear a Title VII suit. Similarly, under the disparate treatment standard, a weak minority employee has a degree of protection from adverse action because he or she can implicitly threaten the employer with the monetary and reputational costs of defending a suit. The disparate impact approach does not have this tendency to protect weaker minority employees. Those employees still must compete with other actual or potential minority employees.

The countervailing cost is that the disparate impact standard may compel employers to employ minority employees who are underqualified. This cost will vary with the labor pool, and will depend on how stringent the numerical requirement is. It will be difficult to weigh this cost against the inefficiencies caused by the disparate treatment approach (such as the protection of weak minority employees) because those inefficiencies are also very difficult to measure. The one thing that can be said, however, is that the disparate impact approach places an upper bound on this category of costs: if they rise too high, the employer can assert a cost defense.

Finally, the administrative costs of the disparate impact approach give it a clear advantage over the disparate treatment approach. It is easy to determine the numerical effect of an employer's practices, and it is relatively cheap to assess a cost justification. Under the disparate impact approach, painstaking inquiries into individual employees' qualifications become unnecessary.

2. Statistical Discrimination

The disparate impact approach is superior in dealing with statistical discrimination for several reasons. First, it directly complements the workings of the market. Recall that inaccurate statistical discrimination is the product of a lack of information about minority employees and is best overcome by inducing employers to sample minority employees. The disparate impact approach forces sampling by requiring employers to hire minority employees. The disparate treatment approach, on the other hand, encourages sampling
only indirectly and at greater cost, by seeking (not always successfully, because of the problems of proof) to deter employers from engaging in statistical discrimination.

In addition, the disparate treatment approach better promotes the objectives of employment discrimination law in this area because it directly combats the three effects that make statistical discrimination troubling—underinvestment in human capital, the perpetuation of past discrimination, and racial stratification. If we want to combat these effects, it is beside the point to try to decide whether a particular employer has engaged in an act of discrimination.

This is clearest in the case of racial stratification. The disparate impact approach directly addresses racial stratification by seeking to improve the status of members of minority groups. One might ask why the employment market is the place to try to make this improvement; but if the answer I gave earlier to that question is satisfactory, the disparate impact approach accomplishes this objective without incurring the pointless cost of proving individual acts of discrimination.

The compensatory justice argument is more complex, but it also favors the disparate impact approach. The best way to implement the compensatory justice ideal would be to determine the extent to which individual members of minority groups had been injured by past wrongs, and to provide redress accordingly. Neither the disparate treatment nor the disparate impact approach does that, and realistically no institution could.

The disparate impact approach provides "redress" (I am assuming a compensatory justice rationale) for those minority employees who are in an industry in which they would ordinarily not receive employment opportunities according to their proportion in the population. Those employees receive the benefit of being able to compete for a larger number of places than the market would allocate to them. There is something to be said for the proposition that this class of minority employees is more worthy of a compensatory benefit: the fact that they are underrepresented in an industry increases the probability that they are suffering especially acutely from the effects of past discrimination. Of course, this is a crude measurement; but that is inevitable, because it is impossible to untangle the effects of past wrongs. Among the minority group members who benefit from this will also be those who have suffered the least. But any approach that incorporates market elements will have that effect: it will reward the best qualified. A system of numerical requirements will at least pull into the labor force borderline minority employees who might otherwise not be hired. That will not happen under a disparate treatment regime.

The disparate treatment approach provides "redress" only to those employees who can prove that they personally were the victims of statistical
discrimination. This seems to be a wholly arbitrary criterion so far as compensatory justice is concerned. Whether statistical discrimination occurs depends on the ease with which an employer can discover information about an employee's qualifications. There is no reason to think that minority employees whose lack of qualifications is more apparent are less likely to be suffering the effects of past discrimination.

Finally, the disparate impact approach may be better suited to curing the problem of underinvestment in human capital by minorities. The disparate treatment approach will ameliorate the human capital problem only to the extent that it is successful in detecting statistical discrimination. The disparate impact approach assures minority group members that they will receive jobs if they can out-compete other minority group members. It therefore provides an incentive for minorities to invest in human capital without the need for detecting individuals acts of discrimination. In that respect, the disparate impact standard is clearly superior.

On the cost side, however, the disparate impact approach will lead to distortions in human capital investments because it will create an artificial demand for minority employees and artificially reduce demand for nonminority employees in certain industries. The magnitude of these effects will, as usual, be difficult to determine. Perhaps the soundest conclusion to draw is that to the extent the case against statistical discrimination rests on the human capital argument, neither the disparate treatment standard nor the disparate impact standard can be shown to be superior; but to the extent that the case against statistical discrimination rests on the other, more far-reaching rationales, the disparate impact approach is clearly superior.

C. THE MORAL AND POLITICAL BASES OF ANTIDISCRIMINATION LAW

It can be objected, with some force, that a disparate impact approach cuts the employment discrimination laws loose from their moral and political moorings.59 I have proceeded throughout this article from the consensus that supports the employment discrimination laws. That is why I have not justified those laws from first principles. But that consensus seems to be a consensus against actual acts of discrimination, not in favor of any form of proportional hiring. If anything, recent political developments suggest a strong consensus against affirmative action “quotas,” as they are called.

An initial response to this objection is that it has to do with the political response to the use of numerical standards rather than with their merit as a means of accomplishing the objectives of the employment discrimination

59. Jerry Mashaw's comments, in particular, have convinced me that this issue cannot be ignored, and I have added this section in response. See Mashaw, Implementing Quotas, 79 GEO. L.J. 1769, 1769-72 (1991).
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laws. My argument is that the objectives underlying the disparate treatment standard—eliminating both taste-based and statistical discrimination—are better achieved not by implementing the disparate treatment standard but by using numerical standards. Numerical standards are a more efficient way of fulfilling the moral premises that underlie the consensus against discrimination. The problem, therefore, is not that the system I propose is actually inconsistent with the moral bases of the antidiscrimination laws; it is a problem of appearances.

The fact that the problem is one of appearances does not make it unimportant, at least for an approach that claims to be based on an actual consensus in society. But the problem is more one of how the program is perceived than of its actual content. There is reason to think that a program emphasizing numerical standards can be politically acceptable so long as it does not become highly visible, and so long as political figures do not find it advantageous to raise the issue.

Programs emphasizing numerical standards, instead of acts of discrimination, have been widespread during almost the entire period that employment discrimination laws have been in force. From an early date, the federal contract compliance program emphasized numerical standards, rather than acts of discrimination. That program has attracted little controversy and has been continued by Presidents of both political parties. In addition, the disparate impact approach has been an important aspect of Title VII enforcement almost from the beginning. Griggs v. Duke Power Co., the Supreme Court case that ratified that approach, was decided in 1971, and the disparate impact approach was in wide use in the lower courts before that time. Griggs was a unanimous decision, endorsed by Congress in the 1972 amendments to Title VII, and not seriously challenged until the 1980s. Minority set-aside plans, probably one of the less appealing uses of numerical standards, had been adopted by the federal government, two-thirds of the states, and about two hundred local governments before the Supreme Court drew many of them into question in a 1989 decision.

This suggests at least two ways in which a program of numerical standards might gain sufficient acceptance. One is if it is implemented in a low-visibil-

ity way. At the time, the Equal Employment Opportunity Commission adopted an enforcement strategy similar to the approach I suggest here—it deemphasized individual claims of discrimination, investigated firms with disproportionately few minority employees, and assured firms that they could be less concerned about individual claims if they had a proportionate number of minority employees. That strategy did not spark controversy.

The second way in which a program of numerical standards might be accepted is if it had a sufficiently broad base of support. If I am right that a program of numerical standards is more efficient than an approach that emphasizes individual claims of disparate treatment, broad support is a real possibility. Some of the efficiency gains from such a system should accrue to employers. In particular, employers might prefer a scheme under which they have flexibility in dealing with marginal minority employees and in which they will be protected against liability so long as they meet numerical standards. The increased predictability and flexibility that employers would enjoy might offset any efficiency losses stemming from the requirement that a certain number of minority employees be hired. If a substantial segment of employers supported a scheme of numerical standards over the current disparate treatment approach, that scheme could achieve the kind of passive acceptance that affirmative action measures have had in the past.

D. AN INSTITUTIONAL PROPOSAL

I will conclude by sketching briefly an institutional arrangement that would implement the theoretical conclusions I have reached. While I cannot fully defend this arrangement, in my view the institutional particulars are matters of detail; if my general conclusions are right, the specific institutional details can be worked out, on a trial and error basis if necessary. This is especially true if the regime is implemented in a low-visibility way. An ad-

67. See Clark, supra note 53, at 1709-11.
68. It is difficult to know how to respond to Professor Williams’s remarks. His central point seems to be that I define a just society as one in which racial groups are proportionately represented in all occupations. A correct view, according to Professor Williams, evaluates social arrangements by considering only the process by which outcomes are produced; it does not have an independent criterion to judge the outcomes. There are many answers. Whether institutions should be judged by the processes that brought them about or by their outcomes is a central issue of political philosophy. One cannot resolve it by defining one’s own position as “the rule of law” and accusing those who differ of having “contempt” for the rule of law. In any event, contrary to Professor Williams, I base a substantial part of my argument on process concerns; both the compensatory justice rationale and the premise that animus-based racial discrimination should not affect people’s fortunes are process-based notions. Anyone serious about a process-based approach must address the compensatory justice argument, which Professor Williams ignores. Nor does he address the argument, central to my paper, that some requirement of proportionality may be desirable not as an end but as a means—not because that is what a just society looks like, but because that is the most effective way of accomplishing objectives that are broadly accepted and that Professor Williams does not disavow.
ministrative agency operating without much publicity would be free to experiment and to find the best arrangements.

My proposal has two components. First, private individuals should not be able to bring suits for discriminatory treatment under the employment discrimination laws. Discriminatory treatment claims should be screened in the way that unfair labor practice claims are currently screened by the National Labor Relations Board: a government agency decides, on the basis of an informal investigation, whether the claim has merit. The agency has discretion to pursue the claim on behalf of the individual if it wishes. If the agency does not pursue the claim the individual cannot. As a practical matter, even under this system, claims of disparate treatment could still be brought as state wrongful discharge actions, and in employment grievance proceedings.

The purpose of this reform would be to reduce the resources expended on disparate treatment claims and to reduce the threat of an unwarranted claim, a threat that can distort employers' decisions. So long as a disparate impact regime is in place, the incidence of disparate treatment should not in fact increase sharply; employers would have strong incentives not to take any kind of adverse action, including discriminatory action, against minority employees, because they need those employees to satisfy the numerical requirement.

The second component of this arrangement would be a system of numerical requirements. This component raises important questions: First, what is the number? Second, what must the employer show to establish its cost justification defense? And third, what is the sanction for noncompliance?

The specific proposal I offer is a requirement that every firm employ minorities in proportion to their percentage in the national population; that there be no explicit cost justification defense; and that the sanction for noncompliance be a fine. Moreover, under my proposal, firms that exceeded the nationwide percentage would be rewarded.\footnote{69. I have added this element to my initial draft in response to Mary Becker's sound point that a system that only punished the failure to achieve national standards would leave employers in areas with high minority population free to discriminate. Becker, supra note 17, at 1685-87.} The system of fines would allow employers to internalize the costs, and a separate cost justification defense would therefore not have to be administered; an employer who found it too costly to meet the requirements would choose to pay the fine. There is no reason that the sanction for noncompliance should be the traditional Title VII sanctions of backpay or injunctions. The objective of this regime is to accomplish certain social purposes, such as deterring taste-based discrimination and avoiding racial stratification. Under the disparate impact model, unlike the disparate treatment model, no individual has an entitlement to be placed in a certain position.
The nationwide percentage requirement that I propose is counterintuitive. It is questionable both because it does not allow for regional variations in minority population and because it does not allow for variations based on the number of minority employees with the necessary qualifications. In the end it may be a poor idea. But there is, I believe, more to be said in its defense than might at first appear.

First, because the sanction for a failure to meet the standard is a fine, the potential dislocations will be limited. If qualified minority employees are too difficult to find, an employer can cap the cost to itself by paying the fine. This, of course, puts great pressure on the choice of a level for the fine. But that level can be adjusted so as to regulate the dislocations.

Second, allowing the numerical standard to vary from region to region would have negative effects. It might create an incentive for firms to locate in areas with low minority population. More important, the problems addressed by the employment discrimination laws should be seen as national concerns. An employer can do its part either by hiring minority employees or by paying a fine. Firms should not be able to opt out of a national effort to address the problem by locating in areas where few minorities live.

Third, variations in the numerical standards based on qualifications would allow minority employees' lack of qualifications to become barriers to their advancement. That would replicate many of the ill effects of statistical discrimination: the lack of qualifications may be (very surely is, to some extent) the result of past discrimination, and it contributes to racial stratification.

Under this arrangement, the crucial question, of course, is the size of the exaction from employers who fail to satisfy the requirement. In principle and at a high level of abstraction, the fine should reflect the gains to society, net of costs, that result from racially proportionate hiring and compensation practices. Determining those gains and costs is of course quite another matter. But at least the inquiry would be focused in the right place—on the possible gains from combating discrimination and the amount society is willing to pay to achieve them.

V. Conclusion

The employment discrimination laws are due for reexamination. Enough has changed in the last generation, and enough new experience has been
gathered, to make the paradigms that ruled in 1964 obsolete. In this paper I have tried to identify the objectives that a system of employment discrimination laws should have. I have considered the extent to which the market can be expected to achieve these objectives and concluded that regulation has an important role to play. But I have argued that the nature of that regulation should change sharply from what it has been.

Specifically, the effort to identify individual acts of discrimination is both costly and ineffective. I do not go so far as to say that this effort should be abandoned, but it should become decidedly secondary. Instead, the principal focus of employment discrimination law should be to induce employers to hire minorities in numbers roughly proportionate to their representation in the relevant population. Working out the details of such a scheme is a daunting task, and I have barely started it here. But it holds more promise than current arrangements of progress toward the important objectives of the employment discrimination laws.