

## ESSAY

### IS TITLE VII EFFICIENT?

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Title VII of the Civil Rights Act of 1964<sup>1</sup> is widely regarded as one of the most important pieces of legislation enacted in this century. Whether one views the Act merely as the confirmation of larger events already well underway<sup>2</sup> or as the pivotal event leading to substantial economic progress for blacks<sup>3</sup> and other minorities, it stands as the most visible legislative pronouncement of this country's commitment to equal opportunity for all Americans.

Despite its undoubtedly heroic ambitions and unrivaled legislative prominence, however, the Act is not without its critics. In fact, some view it as the most conspicuous example of a legislative effort to shape private preferences—an endeavor that is thought to be “at best misguided and more likely tyrannical.”<sup>4</sup> The neoclassical economic model, which rests so heavily on the desirability of aggregating private preferences expressed in the marketplace, has long provided the theoretical foundation for the argument against this antidiscrimination legislation.<sup>5</sup>

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<sup>1</sup> Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000(e)-2000(e)(17) (1982).

<sup>2</sup> See Smith, *Race and Human Capital*, 74 AM. ECON. REV. 685, 686 (1984) (suggesting that the rise in relative black income throughout this century has been an evolutionary process resulting from the narrowing of the human capital disparities between the races).

<sup>3</sup> See Freeman, *Black Economic Progress After 1964: Who Has Gained and Why?*, in STUDIES IN LABOR MARKETS 247, 269 (S. Rosen ed. 1981).

<sup>4</sup> Sunstein, *Legal Interference with Private Preferences*, 53 U. CHI. L. REV. —, — (1986).

<sup>5</sup> See, e.g., M. FRIEDMAN, CAPITALISM AND FREEDOM 108-15 (1962); R. POSNER, ECONOMIC ANALYSIS OF LAW 615-25 (3d ed. 1986); Landes, *The Economics of Fair Employment Laws*, 76 J. POL. ECON. 507, 548 (1968).

Indeed, coupled with the normative principle of wealth maximization, the neoclassical economic model might appear to serve as the basis for unrelenting opposition to any form of government interference in free market outcomes. But, as is now well recognized, legal intervention can also serve to facilitate or enhance the operation of the market, thereby furthering the objective of wealth maximization.<sup>6</sup>

If one looks beyond the traditional static analysis of Title VII and instead evaluates the law in a dynamic context, one finds that the logic of the attack on Title VII is incomplete. As this paper shows, legislation that prohibits employer discrimination may actually enhance rather than impair economic efficiency. Part I of this essay discusses the basic neoclassical economic model of labor markets, Part II examines Gary S. Becker's pioneering analysis of employment discrimination,<sup>7</sup> and Part III summarizes the traditional theoretical argument against Title VII. Part IV then explores the dynamic consequences of this antidiscrimination legislation and demonstrates the invalidity of the conclusion that such legislation necessarily reduces social welfare. Part V offers concluding remarks.

## I. THE NEOCLASSICAL MODEL OF THE LABOR MARKET

Consider the market for labor in a nondiscriminatory world. For a given capital stock, firms have a downward sloping demand for laborers, while the supply curve for laborers slopes upward.<sup>8</sup> The intersection of these two curves, as shown in figure 1, determines the equilibrium wage (the vertical axis) and quantity of labor hired (the horizontal axis).

For those unfamiliar with demand and supply curves, it may be helpful to discuss how they are derived and what they represent. The demand curve for labor is predicated on the assumption that capital is fixed in the short run. The first worker hired by a firm will then have a certain capital stock at her disposal, which is used to generate a certain physical product. The value to the employer of the worker's product is represented by the vertical distance from the horizontal axis up to

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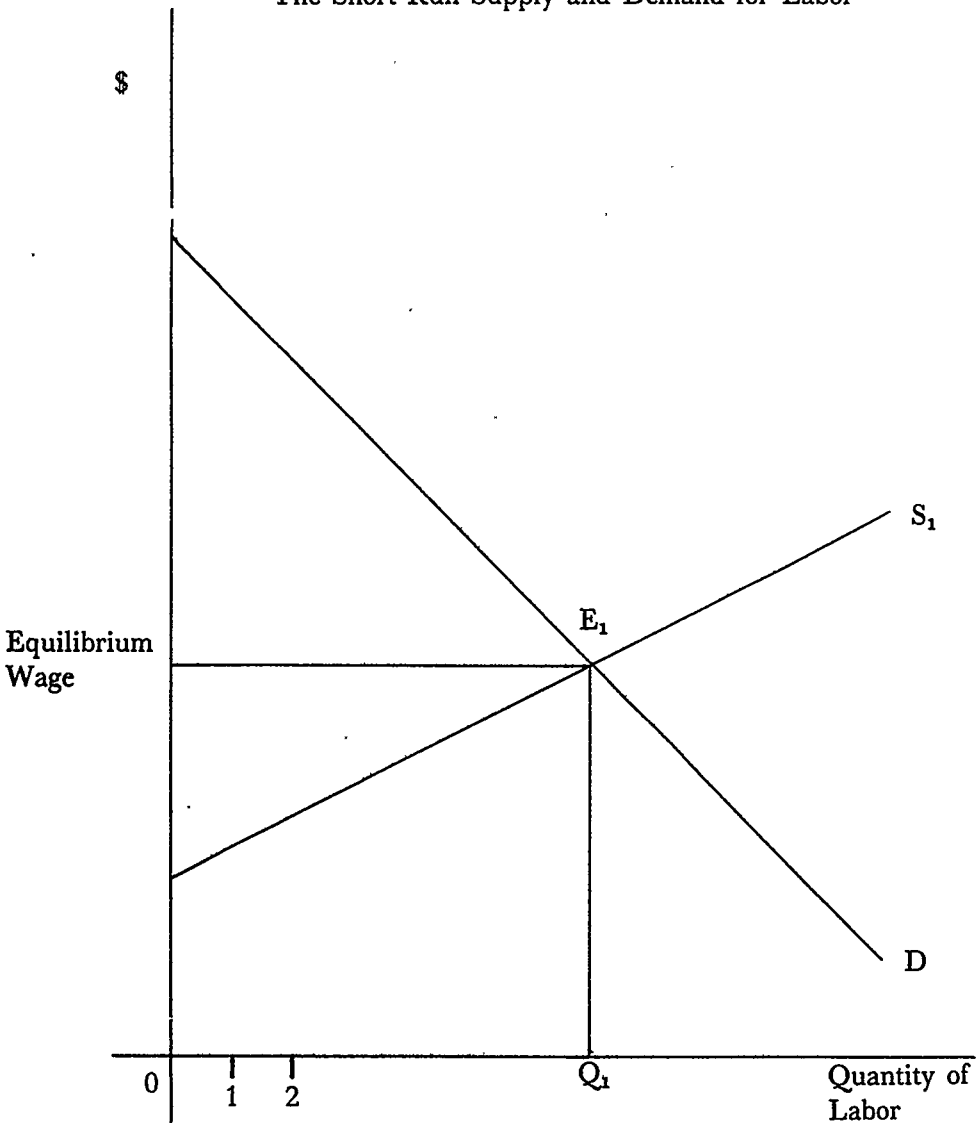
<sup>6</sup> The overarching theme of Posner's *Economic Analysis of Law* is that only one type of intervention tends to enhance welfare: "[J]udge-made rules tend to be efficiency-promoting while those made by legislatures tend to be efficiency-reducing." R. POSNER, *supra* note 5, at 495 (footnotes omitted). See generally R. POSNER, *supra* note 5.

<sup>7</sup> See G. BECKER, *THE ECONOMICS OF DISCRIMINATION* (2d ed. 1971).

<sup>8</sup> The demand and supply curves are drawn throughout this paper as straight lines for computational ease.

Figure 1

## The Short-Run Supply and Demand for Labor



the firm's demand curve and will depend on both the amount of the particular product produced and the price at which the product sells. One can therefore think of the vertical distance to the demand curve as representing the marginal benefit associated with hiring an additional worker.

Of course, to obtain this benefit the employer must incur the expense of hiring that worker. The wage that must be paid to hire an additional worker is given by the vertical distance to the supply curve. The supply curve, therefore, represents the cost to society of employing one extra worker. Put differently, it represents the worker's monetary valuation of the cost of working.<sup>9</sup>

Accordingly, so long as the demand curve lies above the supply curve, society will gain by employing an additional worker. This is because the benefit to the employer of the value of the worker's production is greater than the cost to the worker of working—obviously a mutually beneficial transaction. It is important to recognize a central tenet of the neoclassical economic model: in a world without externalities,<sup>10</sup> market-determined private costs and benefits will equal social costs and benefits. It is this assumption that allows one to conclude that, if the *private* benefit to the employer of receiving the worker's output exceeds the worker's *private* cost of toiling, *social* welfare is increased by hiring the worker.<sup>11</sup>

Once the first worker has been hired, the question becomes whether society would benefit by the hiring of a second worker. Again the supply and demand curves provide the answer. Note that in figure 1 the vertical distance to the demand curve associated with hiring the second worker is less than the vertical distance associated with hiring the first worker, a result that follows from the law of diminishing returns.<sup>12</sup> Moreover, if more workers must be hired, one would expect

<sup>9</sup> If the individual refuses to work unless her wage is at least \$4.00 per hour, then \$4.00 represents the individual's private cost of working (or reservation wage). Since the neoclassical model translates private costs into social costs, \$4.00 also represents the cost to society of having this individual employed. For a clear discussion of the basics of labor supply, demand, and mobility, see R. LIPSEY & P. STEINER, *ECONOMICS* 333-51 (6th ed. 1981).

<sup>10</sup> Externalities are said to

arise when the voluntary economic activities of economic agents—in production, consumption, or exchange—affect the interests of other economic agents in a way *not* setting up legally recognized rights of compensation or redress. . . .

Externalities, therefore, represent sources of social gain or loss that do not get translated into the [private] market signals that constitute the Invisible Hand.

J. HIRSHLEIFER, *PRICE THEORY AND APPLICATIONS* 449 (1976).

<sup>11</sup> For present purposes all of the assumptions of the neoclassical economic model are accepted. For those interested in a more critical assessment of these assumptions, see Baker, *The Ideology of the Economic Analysis of Law*, 5 *PHIL. & PUB. AFF.* 3, 34-37 (1975); Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 *HOFSTRA L. REV.* 509 (1980).

<sup>12</sup> The law of diminishing returns applies in this case because, by assumption, there is a fixed supply of capital and an increase in the quantity of labor working with

the wage offered to rise because more workers must be lured away from alternative opportunities.<sup>13</sup> As the wage offered rises, more workers will be ready to accept this employment, which generates an upward-sloping supply curve. The demand curve still lies above the supply curve in figure 1 when two workers are hired; thus, social welfare would be increased by putting the second individual to work.

This process can be repeated until the intersection of the supply and demand curves at  $E_1$  is reached—the point of maximum social welfare. If fewer than  $Q_1$  workers are hired, the demand curve lies above the supply curve, which indicates that the benefits of additional hiring are greater than the accompanying social costs. On the other hand, if more than  $Q_1$  workers are hired, the costs will exceed the benefits and social welfare would be reduced. Because  $E_1$  represents the point of maximum social welfare it is, by definition, the economically efficient outcome.

## II. INTRODUCING DISCRIMINATION

Thus far, it has been assumed that no discrimination exists in the labor market. Gary S. Becker's pioneering work, however, has shown that the neoclassical model can readily be extended to analyze labor market discrimination.<sup>14</sup> Following Becker, discrimination is now introduced in the form of an aversion by employers to certain groups even though all groups of workers are equally productive.<sup>15</sup>

If, for example, employers have an aversion to black workers, the consequence of this discrimination is, in effect, to shift the supply curve for black labor from  $S_1$  up to  $S_2$ , as shown in figure 2.<sup>16</sup>

this capital. Because the amount of capital per worker has declined, one would expect the marginal product to decline as well. For a detailed explanation of the law of diminishing returns, see R. LIPSEY & P. STEINER, *supra* note 9, at 190-92.

<sup>13</sup> The statement in the text refers to the total supply of labor. This should be distinguished from the supply of labor available to a single firm in a competitive economy, because the firm would be so small relative to the entire labor market that it could hire as much labor as it wished at the equilibrium wage.

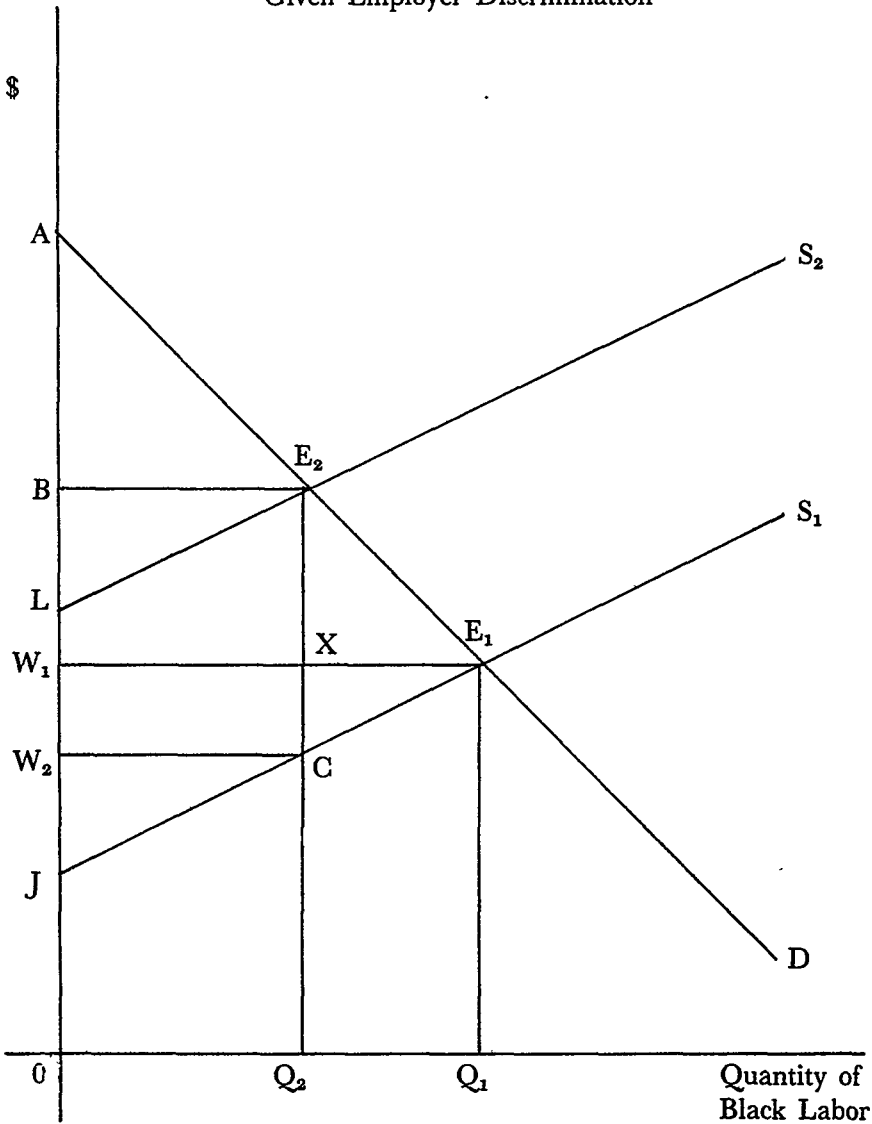
<sup>14</sup> See G. BECKER, *supra* note 7, at 6.

<sup>15</sup> Although Becker considers other models of discrimination—such as discrimination on the part of white employees and customers—he begins his book with the model of employer discrimination, see G. BECKER, *supra* note 7, at 14-18, 39-54. Friedman and Posner afford similar prominence to this model of discrimination. See *supra* note 5.

<sup>16</sup> Intuitively, employer discrimination against blacks reduces the demand for black labor. The supply curve in figure 2 is shown shifting upward rather than the demand curve shifting downward, however, simply for heuristic convenience, as both

Figure 2

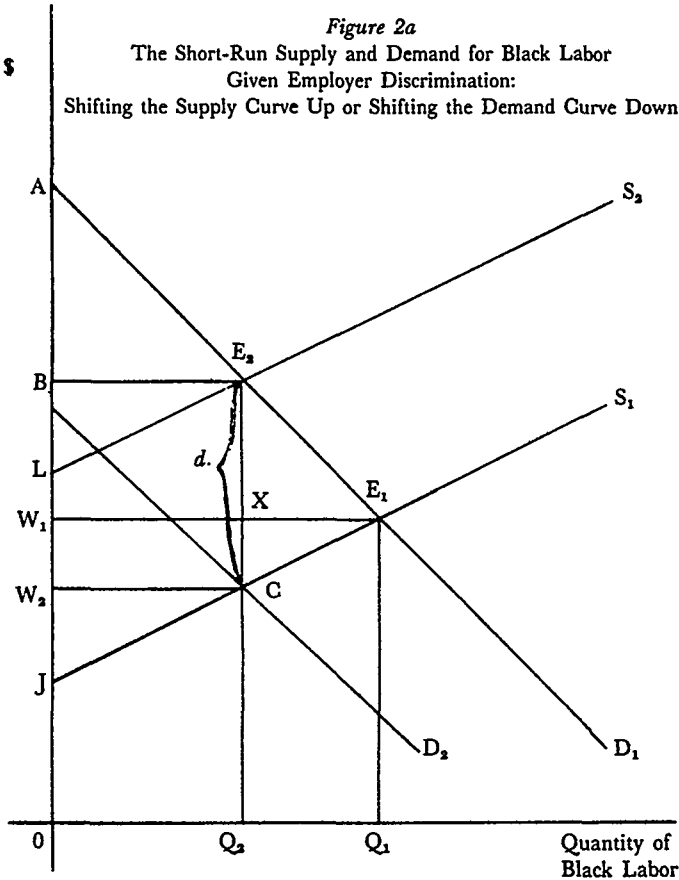
The Short-Run Supply and Demand for Black Labor  
Given Employer Discrimination



This upward parallel shift in the supply curve due to employer distaste

approaches are identical. To see this, note that in figure 2a,  $S_1$  and  $D_1$  are the relevant supply and demand curves in a nondiscriminatory market.

for black workers is exactly analogous to a tax of amount  $E_2C$  on each black worker hired.<sup>17</sup> The benefits derived from hiring additional black



These curves intersect at the market equilibrium  $E_1$  and establish a market wage of  $W_1$  for  $Q_1$  black workers. When discrimination is introduced, the demand for black labor drops by  $d$ , and a new demand curve  $D_2$  is established, where  $D_2 = D_1 - d$ .  $S_1$  and  $D_2$  intersect at  $C$  and establish a new market equilibrium wage of  $W_2$  for  $Q_2$  black workers. If, instead of shifting the demand curve down by  $d$  the supply curve is shifted up by  $d$ , the new supply curve is  $S_2$ , where  $S_2 = S_1 + d$ .  $S_2$  intersects  $D_1$  at  $E_2$ . The resulting wage is again  $W_2$  (because the difference between  $B$  and  $W_2$  is  $d$ , the psychic cost of discrimination) for  $Q_2$  black workers. It is thus mathematically irrelevant, as far as the determination for  $W$  and  $Q$  are concerned, whether the demand curve shifts down (at  $C$ ,  $S_1 = D_1 - d$ ) or the supply curve shifts up (at  $C$ ,  $D_1 = S_1 + d$ ).

<sup>17</sup> To perfect the analogy, one would have to assume that the tax revenues collected are thrown away or wasted.

workers are still given by the same demand curve, but now there is a cost associated with hiring black workers in addition to the previously specified monetary cost embodied in the wage. Thus, to hire the first worker, a discriminatory employer must pay not only the monetary wage but also a psychic or nonmonetary cost associated with hiring a worker for whom she has personal distaste. The analysis then proceeds exactly as before. Employers will evaluate the benefits of increased production from hiring black workers and will offset them against the total costs, both monetary and nonmonetary, of hiring these workers.

The effect will be to reduce the number of blacks hired from the previous level  $Q_1$  to a lower level  $Q_2$ . At the same time, the wage of black workers will fall from the previous level  $W_1$  to a lower level  $W_2$ . The model therefore generates two plausible predictions: (1) discrimination leads to a reduction in the hiring of black labor, and (2) discrimination causes a decrease in black wages.

The effect of discrimination on the welfare of employers is an important and controversial issue. With capital fixed in the short run, employers are interested in maximizing "profits," which are determined by subtracting the total labor cost from the total value of production. In the nondiscriminatory case, profits were given by the area of the triangle  $W_1AE_1$  in figure 2. The total value of production is the area under the demand curve from zero to  $Q_1$  workers, or area  $0AE_1Q_1$ . Employers, however, have paid a wage of  $W_1$  to their  $Q_1$  workers, an amount represented by the area  $0W_1E_1Q_1$ . The difference between what is produced and the cost of production<sup>18</sup> represents short-run profits,  $W_1AE_1$ .<sup>19</sup>

The introduction of discrimination changes the wage and hiring levels for black workers. Because the number of black workers has declined to  $Q_2$ , total production now falls to  $0AE_2Q_2$  and the total wage cost falls to  $0W_2CQ_2$ . But, in addition to the monetary cost imposed by the wage bill, discriminatory employers will also have to bear a non-monetary cost associated with the hiring of black laborers—a type of "discrimination" tax—given by the area  $W_2BE_2C$ . As a result, the net profits earned by discriminatory employers fall to the amount represented by the area of the triangle  $BAE_2$ .<sup>20</sup> The triangle  $BAE_2$  necessa-

<sup>18</sup>  $0AE_1Q_1 - 0W_1E_1Q_1 = W_1AE_1$

<sup>19</sup> To be more precise,  $W_1AE_1$  represents the return on the employers' capital. If this return is less than a normal rate of return, then negative profits are being earned although  $W_1AE_1$  represents a positive area. Only that portion of the return in excess of a normal rate of return is deemed true economic profit.

<sup>20</sup> Net profits for the discriminator equal the value of total production less the cost of wages less the "discrimination tax," i.e.,  $BAE_2 = 0AE_2Q_2 - 0W_2CQ_2 - W_2BE_2C$ .



rily encompasses a lesser area than the triangle  $W_1AE_1$ . Therefore, not only does the black labor force suffer but discriminatory employers are also harmed by the discrimination.

Interestingly, in this partial equilibrium analysis of the black labor market, figure 2 depicts a situation in which the *monetary* profits of the discriminatory employers have risen. The reason for this increase in monetary profits is that the reduction in the hiring of black labor has driven the black wage down to such a degree that monetary profits to the discriminators, represented by  $W_2AE_2C$ ,<sup>21</sup> are greater than the profits of the nondiscriminatory firms, represented by  $W_1AE_1$ .<sup>22</sup> Consequently, the uniform pattern of discrimination has caused employers to make more money but to be less profitable in an economic sense.<sup>23</sup>

The implication that employers may earn more money but be less profitable is not as perplexing as it might first appear. This phenomenon occurs in many contexts throughout the economy, because, quite simply, money is not the only thing that people value. For example, consider a professor who applies for a position at Elite University that pays a salary of \$30,000 and for a similar position at Podunk University, which offers \$40,000. If the professor would prefer to work at Elite in spite of its lower salary, this can be restated in economic terms

<sup>21</sup> Monetary profits for the discriminator equal the value of total production less the cost of wages, i.e.,  $W_2AE_2C = OAE_2Q_2 - OW_2CQ_2$ .

<sup>22</sup> This is true because  $W_2W_1XC$  is greater than  $XE_2E_1$ . In figure 2,  $W_2W_1XC$  is approximately 1.5 as large as  $XE_2E_1$ . This relationship is not invariable, however. See *infra* note 23.

<sup>23</sup> In this partial equilibrium analysis, the effect of discrimination on the monetary profits of discriminators in general will depend on the supply and demand elasticities underlying the curves in figure 2. The elasticity of demand for labor, for example, is the percentage decrease in the quantity of labor demanded resulting from a 1% increase in the wage. Given different elasticities from those depicted in figure 2, it would be possible for discrimination to decrease monetary profits. This would occur if  $W_2W_1XC$  were less than  $XE_2E_1$ .

Determining the effect of discrimination on *monetary* profits becomes considerably more complicated if one allows the effects of discrimination against blacks to affect the equilibrium in the labor market for whites. In this event, the employers' monetary gain from the depressed black wage may be outweighed by the concomitant increase in the white wage rate. Nonetheless, the basic argument of this paper concerning the efficiency of Title VII is not affected by this point.

The issue of the effect of discrimination on *monetary* profits is, however, critical in other settings. For example, Michael Reich examined income data for whites in an attempt to disprove Becker's theory that discrimination hurts discriminators. See Reich, *The Economics of Racism*, in *PROBLEMS IN POLITICAL ECONOMY* 183 (D. Gordon ed. 1977). Reich concludes that white capitalists do better where discrimination is greater, see *id.* at 188. Reich's findings, however, rest on monetary income data, and, as figure 2 shows, it is possible that discriminators are worse off in terms of net welfare (subtracting out the psychic cost of discrimination) but richer as a result of pervasive discrimination against blacks. In that event, Reich's findings, properly interpreted, would not be inconsistent with Becker's model.

to say that the difference in prestige is worth more than \$10,000 to the professor. If she receives an offer only from Podunk, she will earn more money, but will be less satisfied and less well off in economic terms. Just as the prestige-conscious professor has an incentive not to go to Podunk, the discriminatory employers in the Becker model have an incentive not to hire blacks and thereby bear the associated psychic costs. Therefore, Becker's point is that, even though employers may earn more money because of their discriminatory practices, it is not economic self-interest that prompts employer discrimination.

Consider what would happen if discriminatory employers did not really dislike blacks but merely acted as if they did in the hopes of raising their monetary incomes. At first glance, it would appear that such employers could end up at point  $E_2$  in figure 2, earning higher monetary profits without suffering any discriminatory cost. But while nondiscriminatory employers would have an economic incentive to restrict the hiring of black workers to arrive at point  $E_2$ , they would have no power to do so in a competitive market.<sup>24</sup> Indeed, employers could only arrive at the  $E_2$  outcome if they could collude or gain the backing of government. Thus, in this model, it is the government—which may resort to pernicious legislation such as the apartheid laws in South Africa—not the free market, that stands as the potential enemy of the victims of discriminatory conduct.

### III. THE IMPACT OF TITLE VII

Although no one disputes that an unwise or pernicious government can produce socially harmful consequences through interference in labor markets, a more interesting question is whether the government can play a positive role as well. Landes alludes to the traditional view that if one's objective is wealth maximization then the passage of antidiscrimination legislation can only be harmful: "[I]f the benefits [of such legislation] are viewed as the added net (monetary plus psyche) income to the community, then the benefits would be negative, because net income is maximized in the absence of fair employment laws."<sup>25</sup>

The rationale for this contention can be readily illustrated by reference to figure 2. Suppose that, by enacting Title VII, the government succeeds in restoring the nondiscriminatory equilibrium  $E_1$ . Short-run

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<sup>24</sup> In a competitive market, employers would be tempted to offer a wage slightly above the prevailing wage  $W_2$  in order to attract more workers, because at  $E_2$  the demand curve (marginal benefit) is considerably higher than the supply curve (marginal cost). The upward pressure on wages would only stop when the equilibrium point  $E_1$  was reached.

<sup>25</sup> Landes, *supra* note 5, at 548.

social welfare would fall according to this model because the hiring of any workers beyond the  $Q_2$  level would impose greater social costs (represented by the  $S_2$  supply curve) than social benefits (represented by the  $D$  demand curve).<sup>26</sup> The location of  $E_2$  represents the point of wealth maximization, and any attempt to move to  $E_1$  will simply lower total social welfare.<sup>27</sup> Consequently, if one accepts both the Becker model of employer discrimination and the goal of wealth maximization,<sup>28</sup> then the short-run effect of introducing Title VII into a discriminatory environment is clear: to the extent that Title VII has any effect on the labor market, it will be socially harmful.<sup>29</sup>

Opponents of antidiscrimination legislation urge that government action is not necessary because, in the long run, the operation of the competitive market will return the equilibrium level to  $E_1$ . The basic

<sup>26</sup> This discussion abstracts from a number of real world complications. First, the costs of enforcing the antidiscrimination legislation are ignored. Second, the assumption that legislation can move the labor market precisely to the unknown equilibrium that would occur if no discrimination existed is obviously chimerical. Nevertheless, because this would be the result if employers obeyed the law by hiring workers without regard to race, it is a useful assumption in order to analyze the effect of Title VII if its goal were realized. Of course, the effort to discern the nondiscriminatory equilibrium is immensely more complicated in the real world where labor is far from homogeneous and where differences in wage rates reflect not only labor market discrimination but also differences in productivity and occupational choice as well.

<sup>27</sup> According to this neoclassical analysis, although the imposition of Title VII lowers short-run social welfare, it increases the welfare of blacks as well. Blacks are better off at  $E_1$  because the black employment level and wage rate are both higher. Nevertheless, the gain to blacks is economically outweighed by the loss to white employers and social welfare is reduced accordingly.

<sup>28</sup> Once again, determining the wealth that is maximized at point  $E_2$  requires a consideration of both monetary and nonmonetary forms of wealth. Thus, if an employer would gain \$5.00 by hiring a black worker, but would be equally happy hiring a less productive white worker who would provide a benefit of \$3.00, the "wealth" obtained by hiring the black worker is only \$3.00. The remaining \$2.00 represents the psychic cost of hiring a black.

In Posner's system of wealth maximization, wealth is

measured by what people are willing to pay for something or, if they already own it, what they demand in money to give it up. The only kind of preference that counts . . . is thus one that is backed up by money—in other words, that is registered in a market.

Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103, 119 (1979). Thus private costs and benefits are deemed equivalent to social costs and benefits.

<sup>29</sup> This point is axiomatic: because  $E_2$  is defined as the point of wealth maximization, any departure from  $E_2$  must reduce social welfare and is therefore harmful. One could imagine, however, that the enactment of Title VII might alter preferences, thereby changing the configuration of the supply and demand curves. In that event, the intersection of these curves no longer would be at point  $E_2$ , and the point of wealth maximization would change. For instance, if legally enforced integration ultimately caused a reduction in discriminatory attitudes, then the enactment of Title VII might enhance long-run social welfare.

argument is that discriminatory firms are not maximizing profits and therefore eventually will be driven out of the market.<sup>30</sup> The short-run analysis had assumed that the level of capital was fixed. In the long run, however, capital will flow to more profitable enterprises, and any employer that has shunned discrimination will earn higher profits. Such a firm would be willing to hire more black workers at the depressed market wage of  $W_2$  (in figure 2) and would be able to expand production and profits beyond the levels of its competitors. As long as there is a single nondiscriminatory employer, all discriminators will be driven out of the market.<sup>31</sup> Therefore, in the long run the nondiscrimi-

<sup>30</sup> See Arrow, *The Theory of Discrimination*, in DISCRIMINATION IN LABOR MARKETS 3, 10 (Ashenfelter & Rees eds. 1973); Marshall, *The Economics of Racial Discrimination: A Survey*, 12 J. ECON. LITERATURE 852 (1974).

<sup>31</sup> See *supra* note 30. A number of points should be made concerning the prediction that discriminators will be driven from the market. First, a single nondiscriminating firm will be able to drive out all of the discriminatory firms, given constant returns to scale technology. Constant returns to scale technology implies that the firm can expand as much as it wants without suffering from increasing average costs. If average costs rise with increased production, however, more nondiscriminatory firms might be needed to drive out discriminators.

Second, Arrow, while acknowledging that Becker's model predicts the elimination of discrimination, concludes that because discrimination has persisted for decades, Becker's model "must have some limitation." Arrow, *supra* note 30, at 10. Becker might respond that the persistence of discrimination is probably caused by the obstructions to the free market—government, unions, monopolies—and that where the free market exists the model is correct. For an interesting, but ultimately unsatisfactory, attempt to resolve these issues, see Goldberg, *Discrimination, Nepotism, and Long-Run Wage Differentials*, 97 Q.J. ECON. 307 (1982). Goldberg's model demonstrates that discrimination can persist in the market if it is motivated not by animus against blacks but by favoritism towards whites. This demonstration is undermined, however, by the arbitrary and unrealistic nature of Goldberg's basic assumption that favoritism, rather than animus, is the source of labor market discrimination. See *id.* at 314-18.

Third, Nelson and Winter have argued with some force that non-profit-maximizers will not necessarily be driven from the market—a position of such extravagant heterodoxy that it has been largely ignored by those steeped in the neoclassical tradition. See R. NELSON & S. WINTER, *AN EVOLUTIONARY THEORY OF ECONOMIC CHANGE* 139-54 (1982).

Fourth, even if in general, non-profit-maximizers would be driven from the market, it does not follow necessarily that the discriminators discussed in figure 2 will be driven out because they are making *greater* monetary profits than they were in the nondiscriminatory state. Becker might respond with the following example. A discriminatory employer earns a monetary return of 12% on her capital from hiring black workers, but she feels only as well off from this enterprise as she would with an 8% return because of the psychic cost of discrimination. If this employer could invest her capital in a money market fund, earning for example 10%, she would give up her business and earn 10%. The discriminatory employer would try to sell her business to the highest bidder. Although she would not care whether the buyer possessed discriminatory attitudes, the purchaser who is willing to pay the highest price will tend to be a nondiscriminator. This follows from the fact that a discriminator would view the business as an asset that yields an 8% annual return, whereas a nondiscriminator would view it as an asset that yields a 12% annual return. As a result, Becker's prediction that discriminators would be driven from the market would be effectuated. See G. BECKER,

natory equilibrium  $E_1$  will be restored.

The traditional view thus can be summarized as follows: in the short run, antidiscrimination legislation is harmful because it will reduce total social welfare; in the long run, it is unnecessary because the market will restore the nondiscriminatory equilibrium by disciplining discriminators. Within the framework of the neoclassical economic model, this argument has a certain elegance and logical appeal. Nonetheless, it is incorrect. A more discerning dynamic analysis reveals that there is no a priori basis for assuming that Title VII reduces total social welfare.

#### IV. A DYNAMIC ANALYSIS OF TITLE VII

The previous discussion has provided only a static analysis of Title VII. This analysis demonstrated that the total social welfare associated with the nondiscriminatory equilibrium (labeled  $SW_1$ ) is necessarily greater than net social welfare associated with the short-run discriminatory equilibrium (labeled  $SW_2$ ).<sup>32</sup> It will now be useful to consider explicitly how net social welfare will change over time both with and without antidiscrimination legislation.

First consider the case in which Title VII does not exist. Figure 3 depicts the changing level of net social welfare, beginning at time 0, with  $SW_2$  representing the initial short-run net social welfare associated with the discriminatory equilibrium  $E_2$ . As time passes, more and more discriminatory employers will be driven from the market by nondiscriminatory employers, thereby increasing social welfare.<sup>33</sup> Ultimately, when all the discriminatory firms have been driven out, net social welfare will rise to the level of  $SW_1$  associated with equilibrium  $E_1$ —where it presumably will remain. The time path of social welfare in the laissez-faire state begins at  $SW_2$  and rises to  $SW_1$  at time  $2t$ , as

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*supra* note 7, at 39-47.

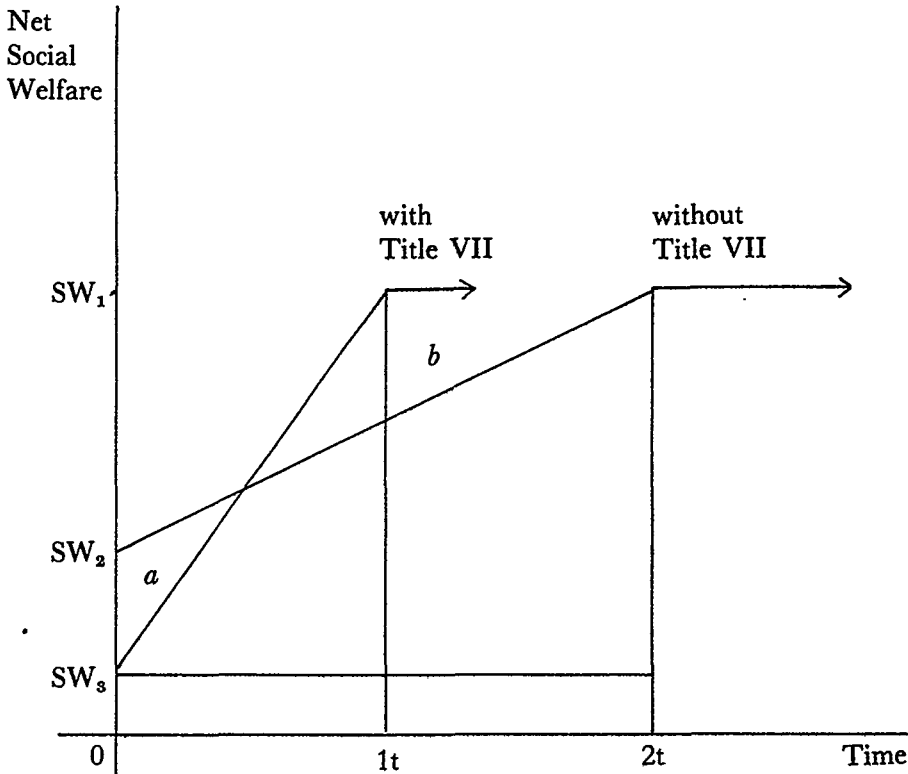
<sup>32</sup> Total social welfare in the nondiscriminatory case is given by the area between the supply and demand curves. This area has two parts: employer profits,  $W_1AE_1$ , and labor's inframarginal rent,  $JW_1E_1$ . Inframarginal rent is the amount of wages paid to labor above that necessary to induce workers to work. Such rents exist whenever the supply curve for labor is upward sloping and all workers receive the same (equilibrium) wage.

Similarly, one can obtain the total short-run social welfare in the discriminatory case by using the shifted-up supply curve ( $S_2$ ) instead of the original supply curve ( $S_1$ ). The area so obtained will be equal to the net profits of the discriminatory employers,  $BAE_2$ , plus the inframarginal rents earned by black labor,  $JW_2C$ .

<sup>33</sup> Social welfare increases when a discriminatory employer of black labor is replaced by a nondiscriminatory employer because the psychic cost of discrimination is eliminated.

Figure 3

## The Time Path of Social Welfare With and Without Title VII



shown in figure 3.<sup>34</sup>

The dynamic pattern of net social welfare would look different if Title VII were adopted at time 0. Initially, as discussed in Part III, net social welfare would be reduced by virtue of the imposition of Title VII. Thus, at time 0, total net social welfare associated with Title VII (labeled  $SW_3$ ) would be less than the unrestrained market outcome (i.e.,  $SW_3 < SW_2$ ).

To dissect the impact of Title VII, however, its effects on the prof-

<sup>34</sup> Merely for heuristic convenience, the time path of social welfare has been illustrated as linear. In the context of this model, the linear time path implies that the number of identical firms driven from the market ( $N$ ) is a proportional function of time ( $T$ ). That is  $N = cT$ , where  $c$  is a constant. Accordingly, the time  $T^*$  at which social welfare reaches  $SW_1$  occurs when all  $N^*$  discriminators have been driven out at  $T^* = N^*/c$ . In other words, if  $c$  discriminatory firms are driven from the market during each time period, then all  $N^*$  discriminatory firms would be driven out after  $N^*/c$  periods.

its of employers as well as on the earnings of black labor must be examined. Figure 4 replicates figure 2 in showing the supply and demand curve for black labor. Once again, the shifted-up supply curve  $S_2$  reflects the total—monetary and psychic—cost of hiring black workers when employers are prejudiced against blacks.

Figure 4

The Short-Run Supply and Demand for Black Labor Given Employer Discrimination: Effect of Title VII

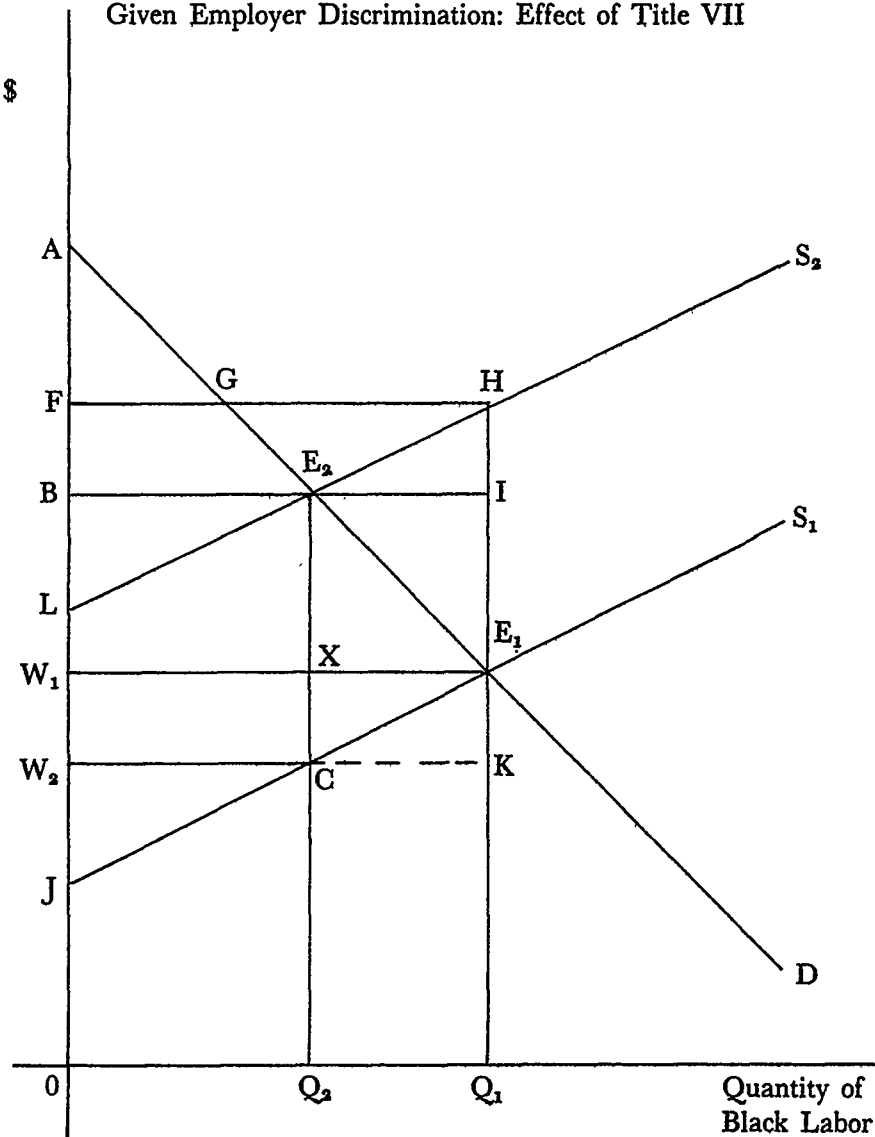


Figure 4 can be used to illustrate that discriminatory firms necessarily will earn lower net profits under Title VII than they would earn without this legal constraint. Imposition of Title VII requires employers to hire  $Q_1$  units of black labor at the nondiscriminatory wage  $W_1$ . The total cost associated with hiring a black worker under the legal constraint of Title VII is  $0F = 0W_1 + W_1F$ , wherein the first term ( $0W_1$ ) represents the wage cost and the second term ( $W_1F$ ) represents the psychic cost of discrimination. Therefore, the total value of production is given by  $0AE_1Q_1$  and the total cost is given by  $0FHQ_1$ .<sup>35</sup> As a result, the net profit to the discriminator under the Title VII regime is  $FAG - GHE_1$ , which is less than the profit of  $BAE_2$ , which is generated in the absence of a legal requirement of nondiscriminatory behavior.<sup>36</sup>

The fact that Title VII causes a reduction in the profits of discriminators has an important implication for the time path of net social welfare: one can assume that discriminators will be driven from the market more rapidly with Title VII than without it. In the long run, the Becker model predicts that discriminators will be driven from the market, thereby elevating net social welfare to the level  $SW_1$  shown in figure 3. But the stochastic nature of the economic environment suggests that for some discriminators the long run will be reached more quickly than it will be for others. Some firms will soon realize that they will be unable to compete and therefore will exit more rapidly, whereas

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<sup>35</sup> The total cost of production equals the total cost of hiring each black worker times the number of black workers hired, i.e.,  $0FHQ_1 = 0F \times 0Q_1$ . Once again, the fixed capital costs are ignored.

<sup>36</sup> The net profits of discriminatory employers (monetary and nonmonetary) will be greater without Title VII ( $BAE_2$ ) than with it ( $FAG - GHE_1$ ) because  $BAE_2$  is greater than  $FAG$  and thus  $BAE_2$  is greater than  $FAG - GHE_1$ . This is plausible because Title VII imposes a constraint on the behavior of employers. Because they can achieve any outcome without the constraint that is available with the constraint, one would expect employers to do at least as well or better without the Title VII constraint.

If the legal constraint did not attempt to impose the nondiscriminatory equilibrium  $E_1$ , as Title VII does, but instead only required employees to pay blacks and whites equal wages  $W_1$ , then employers would stop hiring blacks at the point on the horizontal axis directly below point G and employer profits would equal  $FAG$ . Note that this would reduce the number of blacks hired below the level  $Q_2$  in the laissez-faire discriminatory state. Moreover, because the black wage would be  $W_1$  and at this wage  $Q_1$  blacks would be willing to work, the equal pay requirement would generate involuntary unemployment. Since black unemployment rates became much larger than white unemployment rates in the last two decades, it is possible that employers have responded to Title VII at least in part as if it were an equal wage act. Certainly, in the absence of legal penalties, they would have a monetary incentive to do this because profits with an equal wage act ( $FAG$ ) are considerably greater than profits under Title VII ( $FAG - GHE_1$ ). This pattern of partial compliance with Title VII may reflect the greater ease of proving wage discrimination rather than a discriminatory refusal to hire.



others will try to ward off the inevitable and succumb more slowly to the ineluctable market forces.

Accordingly, the rate of exit  $r$  can be viewed as a stochastic process that is a function of the profit level of the discriminatory firms:

thus  $r_i = k (\pi^* - \pi_i)$  where

$k =$  a positive constant;

$\pi^* =$  a normal rate of return

and

$\pi_i =$  the net profit level of the discriminatory firm in state  $i$ ;

where

$i = 1$  represents the laissez-faire state;

$i = 2$  represents the Title VII state.

Since  $\pi_1$  is greater than  $\pi_2$ , it follows that  $r_1$  is less than  $r_2$ . That is, because profits for discriminating firms are lower with Title VII, these firms will exit from the market more quickly with Title VII than without it.<sup>37</sup>

Consequently, the return to the point of highest social welfare where all discriminators have been driven from the market ( $SW_1$ ) would be far more rapid with the antidiscrimination legislation than in the free market scenario, as shown in figure 3. Thus, while Title VII imposes a short-run cost in net social welfare (i.e.,  $SW_3 < SW_2$ ), it will drive out discriminators more rapidly, thereby elevating net social welfare to the higher level ( $SW_1$ ) more rapidly. So long as area  $b$  is greater than area  $a$  in figure 3, net social welfare would be enhanced by the imposition of Title VII.<sup>38</sup>

Various factors will determine the relative sizes of triangles  $a$  and  $b$ . The smaller the initial net social welfare loss associated with Title VII ( $SW_2 - SW_3$ ) and the faster Title VII accelerates the exit of the discriminators (the more  $r_2$  exceeds  $r_1$ ), then the larger area  $b$  will tend to be relative to area  $a$ . The size of  $SW_2 - SW_3$ , which will always be positive, will depend upon how much Title VII helps blacks and injures discriminatory employers.<sup>39</sup> The size of  $r_2 - r_1$ , which will al-

<sup>37</sup> If profits are normal in the nondiscriminatory state then  $\pi^* = \pi^*$  and the rate of firm exit is zero. On the other hand, if profits are above normal— $\pi^* > \pi^*$ —then the industry will attract entrants, as shown by the negative exit rate.

<sup>38</sup> This statement implicitly assumes a zero rate of discount. If the discount rate were positive, area  $b$  would have to exceed area  $a$  to make Title VII welfare-enhancing because the future benefits would be weighted less heavily than the current costs.

<sup>39</sup> The analysis thus far has assumed that changes in the demand for black workers induced by discrimination or by the passage of Title VII will have only limited impact on the demand for white workers. A more complete analysis should consider the

ways be positive, depends only upon how much Title VII injures discriminatory employers (on  $\pi_1 - \pi_2$ ). These injuries to discriminatory employers will drive them out of business. At the same time, such injuries also yield a lower  $SW_3$ . But note that there is an important offsetting factor at work: although Title VII harms white employers it aids black workers. Thus,  $SW_2 - SW_3$  (the reduction in total social welfare caused by Title VII at time 0) is less than  $\pi_1 - \pi_2$  (the reduction in profits of discriminatory employers). The cost imposed by Title VII, therefore, is properly focused to achieve greater dynamic efficiency; the greater the burden on discriminatory employers, the faster welfare rises to the optimal level  $SW_1$ .<sup>40</sup>

Table 1 clarifies these points.

Table 1

A Comparison of Three States at Time 0 Based on Figure 4

	No Discrimination	Discrimination (Laissez-Faire)	Discrimination (with Title VII)
Net Social Welfare	$JAE_1^*$	$BAE_2 + JW_2C^{**}$	$FAG - GHE_1 + JW_1E_1$
Employer Net Profits	$W_1AE_1^*$	$BAE_2^{**}$	$FAG - GHE_1$
Employer Monetary Profits	$W_1AE_1$	$W_2AE_2C^*$	$W_1AE_1$
Total Black Earnings	$JW_1E_1^*$	$JW_2C$	$JW_1E_1^*$
Psychic Cost of Discrimination	None*	$W_2BE_2C^{**}$	$W_1FHE_1$
Loss in Net Social Welfare Compared to Nondiscrimination State	—	$W_2BE_2E_1C^*$	$W_1FHE_1 = W_2BIK$

\* identifies the state in which the particular characteristic achieves its best (or least bad) value. For example, net social welfare is highest in the nondiscrimination state.

\*\* identifies the second best value.

Total social welfare associated with equilibrium  $E_1$  (the nondiscrimination state) is given by the area  $JAE_1$ —that is, the area below the de-

effects of these factors on the market for white workers as well as on the market for black workers. In such a case, the passage of Title VII would help blacks but harm white workers and discriminatory employers. The omission of the effects on the white labor market has considerably reduced the complexity of the presentation without altering the thrust of the argument.

<sup>40</sup> In the limiting case, where the imposition of Title VII imposed such hardship on discriminatory employers that they immediately left the market by selling their businesses to nondiscriminatory employers, area  $a$  would be eliminated and Title VII would enhance welfare unambiguously.

mand curve but above the relevant supply curve. The introduction of discrimination into this nondiscriminatory world reduces total net short-run social welfare to a smaller amount,  $BAE_2 + JW_2C$ , with the remaining area  $W_2BE_2E_1C$  representing two forms of loss: (1) the loss of the production surplus  $CE_2E_1$  that is not generated because only  $Q_2$  black workers are hired, and (2) the discriminatory cost  $W_2BE_2C$ , which represents the loss associated with hiring the  $Q_2$  blacks. The imposition of Title VII shifts the burden of the social cost of discrimination and increases its size from  $W_2BE_2E_1C$  to  $W_2BIK$ .<sup>41</sup> While the imposition of Title VII decreases social welfare by an area equal to  $CE_2E_1$ , the amount of the loss borne by discriminating firms is greater than  $CE_2E_1$ . This follows because the full weight of the discriminatory burden, which had previously been shared by both discriminators and victims alike, now is shifted totally onto the discriminators.<sup>42</sup>

Burdening discriminatory employers not only promotes arguably normative goals but also has the competitive benefit of more quickly driving discriminators out of the market. In summary, the smaller the sacrifice in initial social welfare ( $SW_2 - SW_3$ ) and the greater the burden on the discriminator ( $\pi_1 - \pi_2$ ) (and therefore the greater the speed with which the discriminators are driven out and social welfare rises to  $SW_1$ ), then the greater the likelihood that Title VII will be welfare maximizing. Both considerations, then, suggest that area  $b$  may well be greater than area  $a$ —that social welfare will be enhanced by the imposition of Title VII.

The following example illustrates the factors that influence the dy-

<sup>41</sup> The loss in net social welfare at time 0 associated with the enactment of Title VII, compared to the nondiscrimination state, is computed in the following manner. In the nondiscrimination state, net social welfare equals  $JAE_1$  ( $JAE_1 = W_1AE_1 + JW_1E_1$ ), which is the sum of employer net profits and total black earnings. Because total black earnings are the same in the nondiscrimination and the Title VII states, we need only to focus on the effect of Title VII on employer net profits, which is given by monetary profits  $W_1AE_1$  minus psychic costs  $W_1FHE_1$ . Thus, the reduction in total social welfare at time 0 from Title VII vis-a-vis the nondiscrimination state equals  $W_1FHE_1$ , which in turn equals  $W_2BE_2E_1C$  (the loss in the discriminatory laissez-faire state) plus  $(E_2IE_1 + CE_1K)$ . The area of the two triangles in brackets equals  $CE_2E_1$ , which establishes that the total cost at time 0 of introducing Title VII into a discriminatory market is  $CE_2E_1$ .

<sup>42</sup> The preceding footnote indicated that: (1) the reduction in short-run social welfare resulting from the introduction of discrimination into a nondiscriminatory market for black labor equals area  $W_2BE_2E_1C$ ; and (2) the additional loss in welfare from introducing Title VII into this discriminatory world is given by area  $CE_2E_1$ . Mathematically, these two statements can be expressed as follows:

$$(1) SW_1 - SW_2 = W_2BE_2E_1C = W_2BE_2C + CE_2E_1$$

$$(2) SW_3 - SW_2 = CE_2E_1$$

This formulation establishes that  $SW_1 - SW_2 > SW_3 - SW_2$ . Therefore, net social welfare at the time of passage of Title VII ( $SW_3$ ) is necessarily closer to net social welfare in the discriminatory state with no legislation ( $SW_2$ ) than  $SW_2$  is to  $SW_3$ .

namic efficiency of Title VII. For simplicity, assume that the time paths of social welfare are linear as shown in figure 3. Assume also that the burdens of Title VII cause discriminatory firms to be driven from the market twice as fast as in the laissez-faire state—social welfare rises to the nondiscriminatory level ( $SW_1$ ) after two periods without Title VII and after one period with it. Because total welfare will be the same after two periods, the effect of Title VII can be evaluated by comparing total social welfare for the first two time periods.

Total social welfare in the laissez-faire state ( $SW_{LF}$ ) and in a Title VII world ( $SW_{VII}$ ) will be given by the area below the respective time paths of social welfare in figure 3:

$$\begin{aligned} SW_{LF} &= 2SW_2 + \frac{1}{2}(2)(SW_1 - SW_2) = SW_1 + SW_2 \\ SW_{VII} &= 2SW_3 + \frac{1}{2}(SW_1 - SW_3) + (SW_1 - SW_3) \\ &= \frac{3}{2}SW_1 + \frac{1}{2}SW_3.^{43} \end{aligned}$$

The imposition of Title VII will enhance social welfare, then, if:

$$\begin{aligned} SW_{VII} - SW_{LF} &> 0; \\ \frac{3}{2}SW_1 + \frac{1}{2}SW_3 - SW_1 - SW_2 &> 0; \text{ or} \\ SW_1 - SW_2 &> SW_2 - SW_3. \end{aligned}$$

Put differently, Title VII will enhance social welfare if the initial reduction in welfare caused by the statute ( $SW_2 - SW_3$ ) is smaller than the initial welfare loss associated with the existence of discrimination ( $SW_1 - SW_2$ ). Under the assumptions of this example, this condition necessarily will hold, and the imposition of Title VII will increase total social welfare.<sup>44</sup>

### CONCLUSION

This essay demonstrates that the theoretical attack on the efficiency of Title VII is seriously incomplete. Without altering any of the assumptions of the neoclassical model, I have attempted to show that it

<sup>43</sup> These figures can be obtained by computing the areas of the respective rectangles and triangles below the two time paths from time 0 to 2 in figure 3. To simplify the computation, a zero discount rate is assumed; in other words, it is postulated that a dollar earned today is equivalent to a dollar earned in the future. Introducing a positive discount rate ( $r$ ) can be accomplished by resort to integral calculus:

$$\begin{aligned} SW_{LF} &= \int_0^2 (SW_2 + t(SW_1 - SW_2)/2)e^{-rt} dt \\ SW_{VII} &= \int_0^1 [SW_3 + t(SW_1 - SW_3)]e^{-rt} dt + \int_1^2 SW_1 e^{-rt} dt. \end{aligned}$$

With a sufficiently high discount rate, the future benefits that are generated by Title VII would be outweighed by the early losses it imposes.

<sup>44</sup> This condition is proved *supra* note 43.

is impossible to claim, as an a priori matter, that Title VII of the 1964 Civil Rights Act reduces social welfare. It is entirely plausible, although ultimately an empirical question, that Title VII can be understood to represent wealth-maximizing legislation rather than as some tyrannical or misguided attempt to disregard private preferences. Indeed, antidiscrimination legislation may be thought of as a tool to perfect the market response to employer discrimination.

The basic argument is that, although Title VII clearly lowers short-run social welfare it also can be wealth-maximizing in the long run. Using the analogy of the turnpike theorem from optimal growth theory,<sup>45</sup> Title VII may take us out of our way at first, but once we get on the turnpike, it gets us where we want to go in less time.

Some may argue that the neoclassical approach is so impoverished that they would rather forgo this defense of Title VII. They may contend that Becker's model cannot be applied usefully to labor markets or employer discrimination, or that wealth maximization is not an appropriate normative goal, and thereby simply reject this entire analysis. Others, while retaining the principle of wealth maximization, might argue that the discriminatory costs represented by the shifted-up supply curve  $S_2$  simply are not legitimate and therefore should not be considered as true social costs. In this case, the appropriate wealth-maximizing outcome once again becomes  $E_1$  rather than  $E_2$ , thereby legitimizing Title VII's mandate. Although this argument has strong moral appeal to the opponents of racial discrimination, it necessarily invites the criticism that the decision to disregard the preferences of discriminatory employers constitutes an unprincipled lapse into subjectivism.

I have not argued that the Becker model is the only way, or even the best way, to analyze employment discrimination. But as long as this model is being used as a weapon to attack the Civil Rights Act, I believe it is important to show that a correct application of this model can buttress—rather than undermine—the case for Title VII. Moreover, to the extent one prefers to see the costs of discrimination borne by the discriminators, rather than the victims (who are undoubtedly less affluent), the normative appeal of the civil rights legislation is enhanced commensurately.

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<sup>45</sup> See, e.g., *McKenzie*, Turnpike Theorems for a Generalized Leontief Model, 31 *ECONOMETRICA* 165 (1963); *Norishima*, Proof of a Turnpike Theorem, The No Joint Production Case, 28 *REV. ECON. STUD.* 89 (1961); *Phelps*, The Golden Rule of Accumulation: A Fable for Growthmen, 51 *AM. ECON. REV.* 638 (1961).

