

ESSAYS

THE EFFICIENCY AND THE EFFICACY OF TITLE VII

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In a recent article in this journal,¹ John Donohue argues that Title VII of the Civil Rights Act of 1964,² which forbids employment discrimination on racial and other invidious grounds,³ may well be an efficient intervention in labor markets, even if efficiency is narrowly defined as maximizing social wealth. His argument is of considerable interest. Social welfare legislation, notably including legislation designed to help minority groups, is usually thought to involve a trade-off between equity and efficiency, or between the just distribution of society's wealth and the aggregate amount of that wealth. If Donohue is right and equity and efficiency line up on the same side of the issue, these laws are considerably less problematic than they have seemed to some observers.

Donohue's argument builds on Gary Becker's theory of racial discrimination.⁴ For Becker, discrimination by whites against blacks is the result of an aversion that whites have to associating with blacks.⁵ This aversion makes it more costly for whites to transact with blacks than with other whites. Becker likens this additional transaction cost to transportation costs in international trade.⁶ The higher those transportation costs are, the less international trade there will be. Countries such as Switzerland that are highly dependent on such trade because

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¹ Donohue, *Is Title VII Efficient?*, 134 U. PA. L. REV. 1411 (1986).

² 42 U.S.C. §§ 2000e to 2000e-17 (1982).

³ Donohue confines his attention to racial discrimination, as will I. Title VII also forbids discrimination on grounds of sex, religion, and national origin. *See* 42 U.S.C. § 2000e-2(a) (1982).

⁴ *See generally* G. BECKER, *THE ECONOMICS OF DISCRIMINATION* (2d ed. 1971). For a brief summary of Becker's theory, see R. POSNER, *ECONOMIC ANALYSIS OF LAW* § 27.1 (3d ed. 1986).

⁵ *See* G. BECKER, *supra* note 4, at 14, 153-54.

⁶ *Id.* at 21 n.3.

their internal markets are small will suffer more than countries that, by virtue of the large size of their internal markets,⁷ are more nearly self-sufficient. Similarly, blacks will be hurt more than whites by the whites' aversion to associations with them because the white community is more nearly self-sufficient than the black.⁸

Just as there are potential gains from measures that lower transportation costs, so there are potential gains from measures that lower the costs of association between whites and blacks. One of these measures is competition. White employers who are not averse to such associations will have lower labor costs and will therefore tend to gain a competitive advantage over their bigoted competitors. Hence competition should, over time, erode the effects of discrimination, not by changing preferences, to be sure, but by shifting productive resources to firms that are not handicapped by an aversion to associating with blacks.

Donohue's argument is simply that this process can be accelerated by a law against employment discrimination, such as Title VII.⁹ By adding a legal penalty to the market penalty for discrimination, Title VII accelerates the movement toward the day when discrimination has been squeezed out of markets and the gains from trade have thereby been maximized.¹⁰ In his analysis, Title VII is like an innovation that reduces the costs of transportation—to zero.¹¹

The obvious objection to Donohue's argument is that he has failed to balance the costs of administering Title VII against the gains from lowering the costs of transacting between blacks and whites. In the year ending June 30, 1986, more than 9,000 suits charging employment discrimination, the vast majority under Title VII, were brought in federal court.¹² The aggregate costs of these cases, and of the many more matters that are settled without litigation, must be considerable. However, I want to emphasize two more subtle points. The first is that, to the extent it is effective, Title VII may generate substantial costs over and above the costs of administering the statute. The second point is that Title VII may not be effective, in which event its administrative costs are a dead weight loss.

⁷ The size of the market should not be confused with the size of the country. The larger a country is, all other things being equal, the greater will be transportation costs in its national markets.

⁸ See G. BECKER, *supra* note 4, at 22-24.

⁹ See Donohue, *supra* note 1, at 1426.

¹⁰ See *id.*

¹¹ See *id.* at 1426-27.

¹² See ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS app. I, table C 2 (U.S. Government Printing Office pub. 1986).

A. *The Efficiency of Title VII*

An analogy in the international-trade sphere to Donohue's argument would be to advocate passage of a law requiring a nation's industries to increase their exports and imports. Such a law would increase the amount of the nation's international trade, but not by lowering the cost of transportation. It might bring the nation to a level of international trade that it would not otherwise have reached for another fifty years through falling costs of transportation, but there would be no gain in efficiency because those costs had not yet fallen.

In Becker's analysis, the costs to whites of associating with blacks are real costs, and a law requiring such associations does not, at least in any obvious way, reduce those costs.¹³ Of course, it makes blacks better off, but presumably by less than it makes whites worse off; for if both whites and blacks were made better off, there would be net gains from association and the law would not be necessary.

Another analogy to international trade may help to clarify my disagreement with Donohue's argument. Consider a law that requires the international maritime industry to adopt a newly developed, more efficient technology; and suppose someone has just invented a type of hull design that enables a ship to sail faster on less fuel. If adopted, the design would lower the costs of international transportation. Donohue's argument implies that a law requiring the adoption of the new technology as soon as possible would increase economic welfare by accelerating attainment of the new, more efficient equilibrium made possible by the invention. The difficulty is that such a law is likely to distort the optimal path to the new equilibrium. It is rarely efficient to scrap an existing technology the minute a superior one is developed. We usually leave it to competition to determine the rate at which the new displaces the old.

The basic difficulty with Donohue's analysis should now be plain. He argues for the efficiency of government intervention in a market not marked by externalities, monopoly or monopsony, high costs of information, or any other condition that might justify such intervention on economic grounds.¹⁴ It might of course be the case that the labor mar-

¹³ See G. BECKER, *supra* note 4, at 153-54. Indeed, Becker argues that forced association between whites and blacks may increase the whites' aversion to blacks and thereby increase the amount of discrimination, but nothing in my analysis depends on the correctness of this argument.

¹⁴ For discussions of how monopsony might affect the economic analysis of discrimination in labor markets, see Culp, *Federal Courts and the Enforcement of Title VII*, 78 AM. ECON. REV. 355 (1986) (Papers & Proceedings); Fischel & Lazear, *Comparable Worth and Discrimination in Labor Markets*, 53 U. CHI. L. REV. 891

kets likely to be affected by Title VII had one or more of these conditions but that is not his argument.¹⁵ It might equally be the case that the costs to whites of being forced to associate with blacks are morally unworthy of consideration in the formulation of public policy. Stated differently, it might be that a tax on those whites for the benefit of blacks would be justifiable on grounds of social equity. But that would not be an *efficiency* justification in the wealth-maximization sense that Donohue employs.

Moreover, it is not altogether plain that a reluctance by white employers to employ blacks *at the same wage as whites* (an essential qualification, as we shall see) must reflect nothing more than an inexplicable aversion, whether by the employer itself or by its white employees, to associating with blacks. Suppose that, because of past exclusion of blacks from equal educational opportunities or for other reasons, the average black worker is less productive than the average white, and suppose further that it is costly for an employer to determine whether an individual worker deviates from the average for the worker's group. Then an unprejudiced employer might nonetheless decide to pay blacks less than whites. This would be unfair to blacks who were in fact above average, yet might still be an efficient method (in the presence of high information costs) of compensating black workers.¹⁶ If Title VII comes along and forbids this method of classifying workers, as it assuredly does, then the employer will either incur additional information costs or, by lumping all workers together regardless of productivity, depart even further from the optimum wage, which is the wage equal to a worker's marginal product. Either way, efficiency will be reduced. Again, gains in social equity may trump losses in efficiency. But Donohue is not concerned, at least in the article under discussion, with equity.

B. *The Efficacy of Title VII*

I have assumed thus far, as does Donohue, that Title VII is effective—that it improves the employment prospects of black people. If it

(1986); Holzhauser, *The Economic Possibilities of Comparable Worth*, 53 U. CHI. L. REV. 919 (1986).

¹⁵ See Donohue, *supra* note 1, at 1414 & n.10.

¹⁶ See generally Phelps, *The Statistical Theory of Racism and Sexism*, 62 AM. ECON. REV. 659, 659 (1972) ("A prior discrimination against minorities may be based on statistical expectations which seem to the employer more cost effective than making individual determination."). Such discrimination may be socially (as well as privately) efficient—or may not be, as argued in Lundberg & Startz, *Private Discrimination and Social Intervention in Competitive Labor Markets*, 73 AM. ECON. REV. 340 (1983); Schwab, *Is Statistical Discrimination Efficient?*, 76 AM. ECON. REV. 228 (1986).

does not, then its administrative costs yield no gains, either in efficiency or in equity. One's intuition is that a law, which imposes sanctions on employers who discriminate and which is enforceable not only by a federal agency (the Equal Employment Opportunity Commission) but by the victims of discrimination in private suits, *must* improve the employment opportunities of members of a group that, at the time the law was passed, was a frequent target of employment discrimination. But this may be incorrect, as Professor Landes showed many years ago in a study of state fair employment practices laws, the precursors of Title VII.¹⁷ Suppose that, for whatever reason, the market wage rate of blacks is lower than that of whites. Title VII forbids the use of race as a ground for pay differentials. Because this part of the law is difficult to evade, and because (as I mentioned earlier) employers find it difficult to measure the marginal product of the individual worker, we can assume that blacks and whites will be paid the same wage by the same employer for the same job. This means, however, that the employer will be paying some or many of its black workers more than their marginal product.¹⁸ The employer will therefore have an economic incentive to employ fewer blacks. The law also forbids making hiring or firing decisions on the basis of race, but this part of the law is very difficult to enforce. To see this, however, it is necessary to get more deeply into the structure of the law than Donohue attempts to do in his article.

There are two basic approaches that plaintiffs can use to make out a case under Title VII.¹⁹ The first, the "disparate treatment" approach, requires proving intentional discrimination.²⁰ This turns out to be exceptionally difficult in practice. No employer of even moderate sophistication will admit or leave a paper record showing that it has refused to

¹⁷ See Landes, *The Economics of Fair Employment Laws*, 76 J. POL. ECON. 507, 544-45 & n.32 (1968) (observing that gains in black wages were partially offset by increased unemployment among blacks).

¹⁸ The employer cannot simply reduce the white workers' wages to the level of the black workers because then the white workers would receive less than their market wage and therefore would go elsewhere. Of course, if all or most employers are affected by the law, the white workers' market wage may fall. But it would not fall all the way to the level of the black workers.

¹⁹ For a brief summary of the elaborate body of legal doctrines that has evolved in the interpretation and application of Title VII, see PLAYER, *FEDERAL LAW OF EMPLOYMENT DISCRIMINATION, IN A NUTSHELL*, pt. 5 (2d ed. 1981). For fuller treatments, see S. AGID, *FAIR EMPLOYMENT LITIGATION: PROVING AND DEFENDING A TITLE VII CASE* (2d ed. 1979); C. SULLIVAN, M. ZIMMER & R. RICHARDS, *FEDERAL STATUTORY LAW OF EMPLOYMENT DISCRIMINATION* (1982).

²⁰ See *Texas Dep't of Community Affairs v. Burdine*, 450 U.S. 248 (1981) (addressing the issue of an employer's intent when an individual claims disparate treatment); *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973) (same).

hire, or has fired, a worker because of the worker's race. In the absence of such evidence, the worker may try to eliminate alternative explanations, but this usually is impossible. There are, it is true, some workers who are so superior that no cause other than racial animus could explain a refusal to hire them or a decision to fire them. But 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. The plaintiff may try to rebut the reason by showing an overall pattern of racial hiring or firing, but this type of proof is expensive and will rarely be cost-justified when all the plaintiff is seeking is reinstatement or back pay, the most common remedies (along with attorney's fees) under Title VII.²¹ Common law damages (including punitive damages) are not available in Title VII cases, and there is no right to trial by jury.²²

Occasionally, a group of workers will band together in a class action,²³ or the EEOC will bring suit against a company or even an industry on behalf of a large group of workers who have been discriminated against. But there are few such cases relative to the vast labor market in the United States,²⁴ and the threat of such a suit may not have much deterrent effect because the available sanctions are so mild.

The second basic approach under Title VII is the "disparate impact" approach. If a firm uses a screening device such as an aptitude test or requiring a high-school degree that has the effect of excluding a disproportionate number of blacks, the device is unlawful unless the firm can show a strong business justification for it, even if the device is not intended to keep out blacks.²⁵ The crux of the problem is identifying disproportionate exclusion. The usual solution is to compare the

²¹ See 42 U.S.C. § 2000e-5(g) (1982) (Title VII's remedial provision); see also C. SULLIVAN, M. ZIMMER, & R. RICHARDS, *supra* note 19, at 69-80 (discussing complexities of statistical proof under Title VII).

²² The Supreme Court has observed that remedies under 42 U.S.C. § 2000e-5(g) are equitable in nature. See *Albemarle Paper Co. v. Moody*, 422 U.S. 405 (1975). The courts of appeals have held, therefore, that there is no right to a jury trial of claims brought under Title VII alone. See, e.g., *Williamson v. Handy Button Mach. Co.*, 817 F.2d 1290 (7th Cir. 1987). The logic of *Albemarle* has also persuaded courts of appeals that punitive damages are unavailable under Title VII, as well as common law compensatory damages (as distinct from backpay). See, e.g., *Protos v. Volkswagen of America*, 797 F.2d 129, 138 (3d Cir. 1986); *Richerson v. Jones*, 551 F.2d 918 (3d Cir. 1977).

²³ See *Frans v. Bowman Transp. Co.*, 424 U.S. 747 (1976); *Albemarle Paper Co.*, 422 U.S. 405.

²⁴ Eighty-two class action suits involving employment discrimination were filed in 1985. Telephone interview with David Cook, Chief of the Statistics Division of the Administrative Office of the United States Courts (Oct. 13, 1987).

²⁵ See *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971).

percentage of blacks employed by the firm with the percentage in the labor pool from which the firm draws. This method of proof makes it more costly for a firm to operate in an area where the labor pool contains a high percentage of blacks, by enlarging the firm's legal exposure.²⁶ Therefore, when deciding where to locate a new plant or where to expand an existing one, a firm will be attracted (other things being equal) to areas that have only small percentages of blacks in their labor pools.²⁷

This incentive exists even if the firm is not worried about disparate-impact suits. Title VII makes it more costly to employ black workers; it also makes it more costly to fire them because the firm may have to incur the expense of defending a Title VII disparate-treatment suit when a black employee is discharged. These costs operate as a tax on employing black workers and give firms an incentive to locate in areas with few blacks.

Thus Title VII can be expected to have several effects: to increase the wages of those blacks who are employed by wiping out racial pay differentials; to eliminate some discrimination in hiring and firing; but, in the case of some employers, to reduce the number of blacks who are employed.²⁸ When the wages of black workers are averaged over all blacks, both those who are employed and those who are not, the average black wage may not have increased (or increased much) as a result of Title VII, and may even have decreased. Any net loss of wealth might be offset by a gain in self-esteem from being freed from direct (though not, if the foregoing analysis is correct, indirect) racial discrimination, but that gain would be outside the scope of the analyses that Donohue and I are making.

Professor Landes, in his study of state fair employment laws, found that the employment and wage effects partially offset each other.²⁹ Unfortunately, it is difficult to make a parallel study of Title VII. Since Title VII is applicable nationwide, cross-sectional studies are not possible. Time studies are confounded by the number of other

²⁶ See C. SULLIVAN, M. ZIMMER, & R. RICHARDS, *supra* note 19, at 46-51.

²⁷ In a recent case, evidence was presented that the defendant "desire[d to] . . . build its plant in a city with a minority population no greater than 35% of the total population, allegedly because it had previously experienced difficulty meeting affirmative action goals in communities with proportionately larger minority populations." *Terry Properties, Inc. v. Standard Oil Co.*, 799 F.2d 1523, 1527 (11th Cir. 1986). I am indebted to Professor Donohue for bringing this case to my attention.

²⁸ See *supra* notes 17-18 and accompanying text.

²⁹ See Landes, *supra* note 17, at 544-45 (finding, in fair employment states between 1939 and 1959, that "the increase in the ratio of non-white to white male wages was partly at the expense of greater unemployment differentials between non-whites and whites.").

developments affecting the wages and employment of blacks since Title VII was enacted in 1964, including changes in welfare benefits (which may affect the incentive to seek employment), changes in the taste for discrimination (besides any such change attributable to Title VII itself), expanded educational opportunities for blacks, the disintegration of the lower-class black family, the shift in jobs from the industrial to the service (including governmental) sector, the increased political clout of blacks, the decline of unions, and a variety of other changes. Disentangling the effects of Title VII from all the other things that have been going on since 1964 and that bear on the wages and employment of blacks seems well-nigh impossible. Even disentangling the effects of all governmental programs to combat racial discrimination from the effects of other developments is extraordinarily difficult and thus far inconclusive, as shown in a recent and very scrupulous review essay by James Heckman.³⁰ Although some studies find that Title VII has increased both the wages and employment of blacks, and others that the wage and employment effects have cancelled each other out,³¹ the most responsible conclusion for the nonspecialist appears to be that the effects of Title VII are unknown.

Of course, Title VII could have indirect effects as well as the direct effects that I have been emphasizing. By putting the government's moral authority behind efforts to eradicate racial discrimination, Title VII may have reduced the aversion of whites to associating with blacks and may have helped blacks overcome the psychological legacy of slavery. As Heckman shows, however, when such indicia of black progress as relative incomes of black and white workers and black and white families, and the rate at which black versus white workers drop out of the labor force before they reach retirement age, are taken into account, one observes not only that black progress has been distinctly uneven, but also that it is not well correlated with Title VII or any other government initiative. Moreover, both the decrease in overt expressions of hostility toward blacks, and the existence of anti-discrimination laws themselves, may reflect the growing political influence and assertiveness

³⁰ See J. Heckman, *The Impact of Government on the Economic Status of Black Americans* (rev. May 1987) (unpublished manuscript) (on file with the *University of Pennsylvania Law Review*).

³¹ Compare Leonard, *Antidiscrimination or Reverse Discrimination: The Impact of Changing Demographics, Title VII, and Affirmative Action on Productivity*, 19 J. HUMAN RES. 145 (1984) (arguing that Title VII has played a significant role in increasing black employment) with Beller, *The Economics of Enforcement of an Antidiscrimination Law: Title VII of the Civil Rights Act of 1964*, 21 J. LAW & ECON. 359 (1978) (arguing that Title VII has not served as an efficient means of increasing the overall wealth of blacks).

of black people and the growing racial tolerance of white people, rather than show that the laws have caused greater tolerance.

To conclude, I am not persuaded by Donohue's argument that Title VII can be defended on strictly economic grounds, as overcoming the transaction-cost barrier to market interactions between white and black people that Gary Becker identified in his economic study of racial discrimination. Title VII, to the extent effective, ignores, rather than reduces, the costs of undesired associations between whites and blacks. It may be correct on moral grounds to do so, but that is not Donohue's argument. Furthermore, it is an open question whether Title VII has improved the net welfare of black people, directly or indirectly. If it has not, then the costs of administering the law are a dead weight social loss that cannot be justified on grounds of social equity.

