

# A supply and demand model of co-worker, employer and customer discrimination

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## Abstract

When racial wage differentials reflect customer, co-worker and employer discrimination, how can these sources of discrimination be theoretically and empirically distinguished? We develop a wage model fashioned around professional basketball that includes customer, employer and co-worker discrimination when there is racial integration. We find that the model is capable of: (1) predicting unexpected effects of the various types of discrimination on wages; (2) the three types of discrimination will interact nonlinearly; and (3) compensation attributable to co-worker prejudice is endogenous. Using data from the National Basketball Association, we find evidence consistent with co-worker discrimination by white players and customer discrimination by nonwhite fans. © 2001 Elsevier Science B.V. All rights reserved.

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## 1. Introduction

In his pioneering work on the economics of discrimination, Becker (1971) suggested three sources of discrimination in the labor market—*employer* discrimi-

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nation, *employee* (or *co-worker*) discrimination and *customer* discrimination.<sup>1</sup> While the literature abounds with studies of racial and gender discrimination in wages, no study has considered all three types of discrimination in a wage model theoretically and empirically. Many of these studies have confirmed the presence of racial discrimination in various industries, but they have generally not been concerned with attributing estimated, *cet. par.* racial wage differentials to a specific source(s) of discrimination.

There are three important reasons why separation of Becker's three sources of discrimination has eluded researchers. First, the traditional methodology used to estimate racial discrimination in wages has precluded the identification of a specific discrimination type in racial wage differentials. This methodology involves estimating the coefficient on a dummy variable indicating the race of a worker in a wage regression.<sup>2</sup> Unfortunately, the estimated coefficient on the worker race dummy cannot pinpoint the source(s) of discrimination because the coefficient could be measuring a combination of all three.<sup>3</sup> Second, no study has tried to empirically distinguish between Becker's three sources of discrimination in a wage regression because little is known about how they might be theoretically distinguished. That is, without formally deriving an equilibrium wage equation from worker and firm optimization, most researchers have only estimated some version of a Mincerian wage regression. Third, when researchers have done tests of specific types of discrimination, they have typically used models that assume

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<sup>1</sup> Assuming discrimination against black workers, Becker characterized employer discrimination as the case where prejudiced white employers charge black workers for the psychic cost of employing them. When there is co-worker discrimination, prejudiced white co-workers demand wage premiums for working side by side with equally productive black workers. If there is customer discrimination, white customers place a higher marginal valuation on goods made by white workers. Becker argued that when there is racial discrimination from any or all of these sources, persistent, *cet. par.* wage differentials can occur.

<sup>2</sup> This dummy variable technique has been the most frequently used technique to test for discrimination. For example, researchers often have used micro data sets such as the *Current Population Survey* or *Panel Study of Income Dynamics* to test for racial or gender wage gaps. The approach typically taken in these studies has been to proxy a worker's productivity by such variables as work experience, educational attainment, occupation, etc., and estimate a Mincerian earnings function using a dummy variable indicating the worker's race or gender. An excellent example of a study using this technique is Blau and Beller (1992).

<sup>3</sup> Kahn and Sherer were aware of this problem in their 1988 study on racial discrimination in the National Basketball Association. They wrote: "While data on [marginal revenue product, performance and compensation] would allow us to distinguish [between the three sources of discrimination], we do not observe [marginal revenue product or actual performance]. Instead, we must proxy [actual performance] by [a series of] player performance indicators and team and local metropolitan area characteristics" (p. 45). Later they wrote: "...lack of data on [marginal revenue product and actual compensation] forces us to combine [the three sources of discrimination] into one coefficient" (p. 45).

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