Chapter 5

Barriers to Economic Equality: The Role of Monopsony, Monopoly, and Discrimination

Markets function well when firms must compete for employees or customers. In competitive product markets, the right amounts of goods are produced to meet demand, with prices that accurately reflect value. In a well-operating labor market, workers are able to switch jobs, wages reflect productivity, and differences in earnings only reflect such factors as ability, effort, education, experience, and random chance.

However, empirical economics research has documented the many ways in which this ideal does not reflect reality. Perfect competition does not describe most labor markets, for example, and not all workers are able to easily move through the labor force to obtain more satisfactory compensation. Two concrete examples are (1) the market power of employers, which allows for unfair hiring and compensation practices; and (2) discrimination, which has exacerbated persistent forms of inequality in earnings across racial and gender lines. Nearly 20 percent of U.S. workers report being bound by noncompete agreements, which limit an employee’s ability to join or start up a competing firm (Starr, Prescott, and Bishara 2021). Also, in general, employer market power is responsible for wages that are at least 15 percent lower than they would be in a perfectly competitive market (U.S. Department of the Treasury 2022). In addition, Federal government statistics show that, on average, Hispanic and Black employees earn less than 80 percent of what white employees earn (BLS 2021). Women earn, on average, roughly 83 percent of what men earn, and the disparities are
even greater for most nonwhite women (Department of Labor 2022a). These earnings differences remain even after accounting for such factors as educational attainment and experience (Blau and Kahn 2017; Borowczyk-Martins, Bradley, and Tarasonis 2017). Although many groups can be targeted by such discrimination—including those with disabilities; lesbian, gay, bisexual, transgender, and queer (LGBTQ+) people; and members of religious minorities—this chapter focuses on discrimination by race, ethnicity, and gender.

Noncompetitive labor markets are not completely devoid of competitive forces, though they generally feature fewer job options, reducing the well-being of workers, and discriminatory barriers, resulting in a misallocation of talented workers. Broader costs for the overall economy include lower productivity and slower economic growth. New Deal labor reform laws sought to protect workers by establishing the right to bargain collectively, establishing a floor for wages, and providing protection from overwork, while the Civil Rights Act sought to break through discriminatory barriers across all kinds of economic activity, including in the labor market (Boone 2015). Emblematic of these laws’ success, Hsieh and others (2019) estimate that the removal of barriers to higher-income occupations for women and people of color accounted for 20 to 40 percent of growth in output from 1960 to 2010; this was driven by an improvement in the allocation of talented workers within the economy.

Despite this progress, barriers to equality in the workplace remain today, in no small part due to the market power of employers. The opening section of this chapter provides a summary of current levels of inequality in wages, income, and wealth. The next sections document the forces that inhibit workers from being fully rewarded for their skills in labor markets—such as excessive wage-setting power by employers and racial and gender discrimination—and discuss how these forces impede economic growth. The final section discusses several policies, including legal measures designed to protect workers and members of disadvantaged groups and more general
economic policies with the potential to counteract the adverse effects of a lack of competition—thereby, reducing inequality as well as boosting economic growth. The chapter finishes with a discussion of tax reforms that can help to offset inequality that may remain even if barriers to healthy competition are removed.

**Labor Market Inequality**

Research reveals the significant scope of economic inequality—in wages, incomes, and wealth—in the United States (Gould 2019; Congressional Budget Office 2021; Piketty 2014; Wolff 2021). These inequities across demographic groups cannot be fully explained by differences in such characteristics as education or experience that provide an indication of their productivity, suggesting that people may not be equitably rewarded for their economic contributions. This section reviews current patterns of inequality, with a primary focus on wage inequality by race, ethnicity, and gender. For most households, earnings account for most of their income; thus, wage inequality translates to income inequality. Wealth inequality reflects earnings and income inequality—as well as disparities in access to capital, returns on those assets, and transmission of wealth across generations (see box 5-1).

Figure 5-1 shows that, while net productivity has grown by nearly 62 percent over the past four decades, average hourly pay for the typical worker

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**Figure 5-1. The Gap Between Productivity and Worker Compensation, 1948–2020**

*Cumulative change (index: 1979 = 100)*

Box 5-1. Racial and Ethnic Wealth Gaps

Although differences in income across groups typically provide an account of inequality in resources on an annual basis, wealth disparities track how these income flows can contribute to divergences in accumulated resources across longer time periods and even over multiple generations. A household’s net worth, measured as the difference between its assets and its debts, has many components. For most American families, the largest single asset is their home; thus, the largest portion of net worth is often tied to the value of one’s home minus the mortgage or the other debts against it. Net worth also includes savings and retirement accounts, stocks and or other property, and inheritances and gifts from family members. Sources of debt also include credit card balances and loans for education, vehicles, or durable goods.

In the United States, there are substantial racial wealth gaps, as shown in figure 5-i. In 2019, the net worth of the median white family was $199,498, almost eight times higher than that of the median Black family and five times higher than that of the median Hispanic family (Bhutta et al. 2020). The average net worth within each group is higher than the median, because the average incorporates information about the ultrawealthy, who account for a large proportion of overall wealth: The average white family has nearly seven times more wealth than the average Black family and almost six times more than the average Hispanic family.

The causes of current wealth inequality are complex, as today’s net worth reflects the accumulation of differences in past income between racial groups, differences in savings rates for households with similar incomes, differences in the return to savings for households with similar savings rates, differences in transfers of wealth between generations, and the possibility of individual-level and/or structural discrimination at any

![Figure 5-i. Median and Average Wealth by Race and Ethnicity, 2019](image-url)
has increased by just under 18 percent (Economic Policy Institute 2021). The divergence between the two trends suggests that there may be forces suppressing the pay of workers relative to their productivity.

### Racial, Ethnic, and Gender Wage Gaps

There are substantial differences in the wages paid to white women, and to Black, Hispanic, American Indian, and Alaska Native workers of any gender, relative to white men, and some differences remain even after accounting for differences in education, occupation, and experience. Focusing just on differences in educational levels, as shown in figure 5-2, reveals the basic pattern. In 2021, Black workers were paid less than white workers, on average at every education level, with the Black/white wage ratio ranging from 76 percent to 91 percent. Hispanic, American Indian, and Alaska Native workers were paid less than white workers at all but the lowest level of education (less than a high school degree). The patterns suggest that differences in earnings between these groups are driven by more than simply such differences as educational attainment and level of experience.

The wage profile of Asian American, Native Hawaiian, and Pacific Islander workers (AANHPI, or “Asian” for short) is distinct from that of other nonwhite groups. Asian workers earn more than white workers, on average, at most education levels. However, the overall group average
masks a substantially higher within-race wage inequality among Asian people than that found within other groups. This can be captured by comparing the wage of the worker at the 90th percentile in earnings, including earnings among salaried workers, with the wage of the worker at the 10th percentile. In 2021, among Asian people, the worker at the 90th percentile earned $81 an hour, 6.4 times more than the worker in the 10th percentile, who made almost $13 an hour. Meanwhile, among the other racial and ethnic groups, the wage of the 90th percentile worker was only 3.5 to 4.8 times as large as that of the wage of the 10th percentile worker. The varied experiences of Asian workers are further demonstrated by comparisons across different ethnic subgroups within the larger group (see box 5-2).

There are also earnings differences by gender: women are paid less, on average, than men. Although the wages of both men and women increase with education, figure 5-3 shows that the gender wage gap is even larger for those with more education. Among those with an advanced degree, the average wage for women is 70 percent of that for men.

As laid out by Crenshaw (1989), examining inequality along one dimension of identity at a time may obscure the specific experiences that lay at the intersection of race and gender identities. Figure 5-4 therefore presents wages separately by race and gender. On average, Black women’s wages are 62 percent of white men’s wages, while Hispanic and American Indian / Alaska Native women’s wages are 59 and 62 percent of white men’s wages, respectively. The average wages of Asian women are higher than those of women in the other racial and ethnic groups, though still below those of white men. In addition, Asian women experience a larger within-race gender
gap than women in any of the other racial and ethnic groups, earning 73 percent of the average wage of Asian men. It is important to note that, as seen in figure 5-4, the lower gender wage gap among Black, Hispanic, American Indian, and Alaska Native workers is partly due to the relatively low wages earned by men in these groups.
Box 5-2. Improving Data Infrastructure for Equity Analysis

Understanding the mechanisms underlying the inequality discussed in this chapter involves gathering evidence, both quantitative and qualitative. Research plays an important role in uncovering these patterns, and shedding light on issues related to equity across different groups requires adequate information and data on the many dimensions of an individual’s identity. However, many barriers remain to collecting the information needed for such equity analysis.

First, the existing set of questions typically asked on household surveys may not be detailed enough to capture certain important subpopulations. This may prevent the discovery of unique outcomes for important subgroups and can reduce the accuracy of equity analyses by lowering rates of self-identification among respondents who do not see themselves represented in the available categories (Census Bureau 2021). Members of Asian American, Native Hawaiian, and Pacific Islander racial/ethnic communities, for example, are commonly grouped together, masking the greater economic challenges faced by some subgroups within the broader category. This is demonstrated in figure 5-ii, which shows a great deal of variation in average income across subgroups of this population. In addition, survey respondents of Middle Eastern and North African origin generally do not have a satisfying option to select in the standard list of racial and ethnic categories, which may result in higher rates of nonresponse to these questions. Likewise, the concepts of sex and gender are often collapsed into binary categories that exclude a number of gender identities and expressions.

Moreover, even when surveys do have questions that capture key aspects of identity, the survey sample size may be too small to be representative of certain groups in the population, and privacy concerns may require suppression of statistics for those groups to prevent tracing the information back to a specific respondent. For example, before February 2022, labor force statistics from the Current Population Survey for American Indian and Alaska Native respondents were not reported as a separate category, due to small sample sizes. Likewise, statistics on wealth and net worth from the Survey of Consumer Finances are released publicly for Black, white, and Hispanic respondents, separately, but not for Asian, Native Hawaiian, Pacific Islander, American Indian, or Alaska Native respondents (Bhutta et al. 2020).

A second concern is that many key economic indicators are measured using administrative data; that is, data are collected for the purposes of implementing a program, and not necessarily with the primary purpose of facilitating general research analysis. In these cases, it may not be necessary to collect demographic information, and may be counterproductive or illegal to do so. For example, administrative tax
data have proven useful in analyses of income inequality by incorporating the incomes of the ultrarich, but the Internal Revenue Service does not collect many demographic characteristics on the 1040 tax return (Huang and Taylor 2019). Such demographic data are also not typically collected for other key programs that generate useful data for tracking economic outcomes, such as the Unemployment Insurance (Kuka and Stuart 2021) programs across different states, and the Supplemental Nutritional Assistance Program (Prell 2016).

There are possible solutions to the issues outlined above, and some efforts are under way to facilitate equity analysis. The Biden-Harris Administration’s Executive Order on Advancing Racial Equity and Support for Underserved Communities Through the Federal Government established an Equitable Data Working Group, an interagency committee, to explore ways to make available data disaggregated by race, ethnicity, gender, and other key demographic variables (Nelson and Wardell 2021; White House 2021a). These include a comprehensive review of race, ethnicity, and gender-related questions on Federal
These wage gaps reflect the fact that women—particularly nonwhite women—and most nonwhite men are overrepresented among the low-wage workforce. For example, in 2021, nonwhite men made up 39 percent of all men in the workforce, but over half (51 percent) of low-wage men in the workforce. Likewise, nonwhite women made up 39 percent of all women in the workforce and 45 percent of low-wage women in the workforce.

The gender pay gap has narrowed over time, partially as a result of women increasing their skills through educational attainment and greater labor market experience. Women are now better educated than men—being more likely than men to graduate from college and earn graduate degrees (National Center for Education Statistics 2022). The share of women in the labor force (either working or actively looking for work) nearly doubled from 1950 to 2000, from 33.8 percent to 59.9 percent (BLS 2022a). Boustan and Collins (2014) show that these historical trends have varied across racial groups: the labor force participation rate for Black women, for example, was

surveys, and exploration of the possibility of merging Federal datasets to append demographic information to administrative data. An example of the type of analysis possible is the ongoing collaboration between the U.S. Treasury and U.S. Census Bureau to merge individual-level data on race and ethnicity with tax data to study when members of different racial groups received their first Economic Impact Payment as a part of the 2020 CARES Act (Adeyemo and Batchelder 2021; U.S. Congress 2020).

The Administration’s National Strategy on Gender Equity and Equality calls for the collection of gender-disaggregated data to better track outcomes such as gender gaps in the labor market and entrepreneurship, financial outcomes, including within households, and gender-based violence (White House 2021b). In another case, the U.S. Census Bureau’s Household Pulse Survey, designed to provide real-time tracking of outcomes during the COVID-19 pandemic, for the first time introduced separate questions about sexual orientation and gender identity on a Census Bureau survey in July 2021 (File and Lee 2021).

In terms of data by income group, the 2022 Green Book included proposed funding to share data between the Treasury and Bureau of Economic Analysis (BEA), which would aid in the estimate of the distribution of income growth across different income percentiles (U.S Department of the Treasury 2021a, 101). BEA has explored prototype estimates of the distribution of personal income, which covers outcomes as recently as two years in the past; and recent developments, such as the Realtime Inequality project (Blanchet, Saez, and Zucman 2022), demonstrate the potential for even more timely estimates at a higher frequency from BEA (U.S. Bureau of Economic Analysis 2021).
14 percent higher than that of white women in 1950, and the two rates did not converge until about 1990.

However, the increase in women’s labor force participation has stalled since 2000, and the gap between the share of men and women in the labor force has remained fairly steady since that time in the United States, while such gaps continued to shrink across many other countries that belong to the Organization for Economic Cooperation and Development (OECD) (Blau and Kahn 2013). In 2019, before the COVID-19 pandemic, 58 percent of women and 69 percent of men were in the U.S. labor force. One general factor at play is parenthood; on average, prime-age (age 25 to 54 years) women with children have lower labor force participation rates than those without children, as shown in figure 5-5. However, there is variation in participation patterns across women of different racial and ethnic backgrounds, and the relationship between parenthood and participation does not hold for Black and American Indian women and for Alaska Native women, whose participation rates do not substantially differ by motherhood status. This differential pattern may in part be driven by a greater share of women in these groups being the breadwinners for their household (Institute for Women’s Policy Research 2016) and therefore less able to afford to exit the labor force.

A number of studies have also documented a concentration of income among the richest households. This is the result of the wage inequality discussed above, including relatively high rates of compensation for executives (Mishel and Kandra 2021), and the fact that the highest-income households receive a disproportionately high share of capital income earned from assets.
and savings. The most recent estimates show that, in 2021, the top 1 percent received 19.5 percent of pretax income, as compared with only 11.4 percent for the bottom 50 percent of the population (Blanchet, Saez, and Zucman 2022). Although there is some variation in such estimates due to differences in data and methods, various studies find that between 14 and 20 percent of income has been accrued by the top 1 percent of households in recent years (Piketty, Saez, and Zucman 2018; Auten and Splinter 2020; Internal Revenue Service 2021; Congressional Budget Office 2021). There is also considerable income inequality among households below the top 1 percent. For example, in 2018, U.S. households at the 90th percentile of the income distribution earned 12.6 times more than households at the 10th percentile (Horowitz, Igielnik, and Kochhar 2020), a ratio that is among the highest for OECD countries (OECD 2022).

**Sources of Earnings Inequality**

This section explores how earnings inequality can arise from noncompetitive market forces and discriminatory barriers. A robust and growing body of evidence shows that some degree of economic inequality stems from forces inconsistent with competitive markets. In a noncompetitive market, barriers emerge that prevent some individuals from realizing the gains from their productivity. This chapter focuses on two specific aspects of noncompetitive markets: the market power of employers, and discrimination. New empirical research provides evidence that many firms have some power to set wages, violating the core tenet of a competitive labor market (Card 2022), and allowing for persistent differences in outcomes across racial and gender lines.

These are not the only sources of earnings inequality; nor does the presence of inequality necessarily imply that labor markets are not competitive. For example, even a random event such as a serious illness could have implications for an individual’s potential earnings. Earnings inequality can also appear within competitive markets due to differences in worker productivity. A worker’s skills and experience—that is, their human capital—affects their marginal productivity, as discussed more fully in chapter 4. A large body of research has focused on productivity-related explanations for inequality, examining the roles of technological change, innovation, and trade policy that have increased the productivity of some workers while replacing other workers whose jobs could be outsourced or automated (Autor, Levy, and Murnane 2003; Autor, Katz, and Kearney 2006; Acemoglu and Autor 2012; Autor 2010). Recent work has found evidence that import competition from China and other developed economies has had adverse effects on U.S. employment in manufacturing and per-capita income in more trade-exposed labor markets, particularly among workers with less
than a college degree (Autor, Dorn, and Hanson 2013, 2016; Hakobyan and McLaren 2016). Further, these adverse effects spill over to overall employment and persist long after the initial severe loss of manufacturing jobs (Autor, Dorn, and Hanson 2021).

A Lack of Competition in Labor and Product Markets

Noncompetitive markets can emerge under many conditions, such as when mergers result in dominant firms that can use their consolidated market power to charge higher prices, offer decreased quality, and block potential competitors from entering the market (Boushey and Knudsen 2021). A distinguishing feature of noncompetitive markets is the existence of “economic rents,” which are profits derived from prices that are higher than needed to cover the investment and production costs of goods. In a perfectly competitive market, neither workers nor firms earn such rents in the long run; if there are excess economic rents in a product market, for example, this would create an incentive for new firms to enter the market, which in turn would drive down prices and rents. A critical question in noncompetitive markets is how the economic rents are split between employer profits and employee wages. When firms use their market power to capture a greater share of economic rents, the outcome can be “suboptimal”; meaning that, from society’s point of view, workers are paid too little or firms charge too much for their products. Another implication of noncompetitive markets is that they provide an incentive for firms to do less, not more. If the firm has labor market power, theory says it will restrain hiring to maintain low wages, because adding more employees would mean paying higher wages to lure new applicants. Similarly, a firm with product market power will restrain production in order to charge higher prices than it would if it had competitors. This subsection explains how a lack of competition not only affects efficiency but also can exacerbate labor market inequality.

Labor market monopsony. The classic form of a noncompetitive labor market is a monopsony. In the case of a pure monopsony, a concept first developed by Joan Robinson (1933), there is a single employer that uses its market power to set wages below what the competitive rate would be; that is, the firm has the power to set such wages. Robinson’s theoretical model of a single employer has been extended to incorporate the concept that an employer’s monopsony power can come from representing a larger share of the labor market, which limits the options of employees to push toward competitive wages. Employers may also derive monopsony power from situations where it is difficult for workers to switch jobs due to issues of commuting distance or workplace scheduling flexibility, which give employers greater power to set wages (Manning 2020a). Stelzner and Bahn (2021) argue that, because female and nonwhite workers may be more likely
to experience these difficulties, monopsony power can translate into greater gender and racial inequality.

A number of studies focus on a direct measure of monopsony power by estimating a firm’s ability to adjust the wages it offers, as opposed to offering a market wage that a competitive market would demand. Using job applications data, Azar, Berry, and Marinescu (2019) find strong evidence of this monopsony power in many markets, and they conclude that workers’ productivity is 17 percent higher than the wage they receive. There is similar evidence of monopsony power even in online, on-demand labor markets where the costs of searching for and switching jobs should be relatively low (Dube et al. 2020). A meta-analysis of 53 studies concludes that, overall, the literature provides strong evidence for monopsony power among many employers, implying sizable markdowns in wages (Sokolova and Sorenson 2020). Importantly, two studies find that the degree of monopsony power is substantially larger in low-wage labor markets (Bassier, Dube, and Naidu 2021; Webber 2015). Moreover, research by Webber (2015, 2016) shows that the negative effect of a firm’s market power on wages is strongest in the lower half of the earning distribution and among female workers, suggesting that monopsony power amplifies both overall and gender wage inequality.

One way that a firm can derive monopsony power is from providing a large share of the jobs available in a local labor market. Economic research has found a link between higher labor market concentration and lower wages (Azar, Marinescu, and Steinbaum 2019; Benmelech, Bergman, and Kim 2020, CEA 2016; Philippon 2019; Qiu and Sojourner 2019; Rinz 2020). Two recent studies find that wages are lower when concentration in local labor markets increases due to mergers and acquisitions (Arnold 2019; Benmelech, Bergman, and Kim 2020). A third study focuses on hospital mergers and finds that they decrease the wage growth of workers whose skills are specific to their industry (Prager and Schmitt 2021). Recent research has raised the question of whether employers are able to gain or maintain a greater share of the labor market through actions that may violate antitrust laws (Naidu, Posner, and Weyl 2018; Posner 2021).

Monopsony power can also arise from practices that reduce the outside options of workers (Manning 2020b). One such practice is the use of noncompete agreements, which prohibit employees from joining or starting competing businesses, typically within a specified time frame or geographic boundary. Starr, Prescott, and Bishara (2021) find that almost 20 percent of U.S. workers were bound by a noncompete agreement in 2014, including 12 percent of workers with annual income less than $20,000. Such agreements are increasingly used by employers in low-wage industries, such as fast food chains and home health agencies (Quinton 2017). A recent study found that when Oregon initiated a ban on noncompete agreements, wages rose by 2 to 3 percent, with larger effects in occupations where noncompete agreements
were more common (Lipsitz and Starr 2021). Johnson, Lavetti, and Lipsitz (2021) examine this relationship in the national context, and find that greater enforcement of noncompete agreements reduces earnings, with stronger negative effects on the earnings of female and nonwhite workers.

Some employer practices hamper worker mobility by impeding their ability to gain information about important characteristics of potential jobs, such as expected compensation and working conditions. For example, nondisclosure agreements (NDAs), which are often bundled with noncompete agreements in employment contracts, prevent an employee or former employee from disclosing information about employers. Though NDAs can be used to protect confidential business information, some are much more broadly applied and can reduce the ability of workers to share information about the work environment. Research suggests that overly broad NDAs can reduce the reporting of workplace harassment (Sockin, Sojourner, and Starr 2021). Workers may also lack information on the wages offered at other jobs, partly due to employer practices that promote pay secrecy. Research has shown that workers, especially those with low incomes, are unaware of potential higher-paying job options (Jäger et al. 2021), and that reducing pay secrecy could reduce the gender wage gap (Baker et al. 2021).

Another practice that can reduce workers’ mobility are no-poach agreements, which are compacts made between employers agreeing to not hire workers from each other for a specified period of time. Employees may not even be aware that these agreements are in effect, and because no-poaching agreements between separate employers are illegal per se under antitrust laws, and therefore hard to discover, it is difficult to know how common they are. In a slightly different context, Krueger and Ashenfelter (2021) documented that in 2016 almost 60 percent of franchise agreements, including for some major fast-food chains, contained no-poaching clauses. The study also found that no-poaching clauses were more common for franchises in low-wage and high-turnover industries, though a number of fast-food franchises have already dropped them from their franchisee contracts in response to public pressure and legal challenges (Abrams 2018).

Product market monopoly. Whereas a pure monopsony refers to a market with a single buyer, a pure monopoly refers to a market with a single seller. Accordingly, a firm gains greater monopoly power when the market in which it sells products is more concentrated—what is often referred to as an oligopolistic market—with just a handful of sellers. This allows the firm to charge higher prices and leads them to produce less than it would if it faced greater competition. In addition, Boushey and Knudsen (2021) cite growing evidence that market concentration has reduced innovation and economy-wide investment in the United States.

Product market concentration may also contribute to economic inequality. This can occur when firms with market power are able to set
prices above what they would be in a competitive market. This pricing power harms consumers but improves the payoffs to shareholders, as explored in recent research (Gans et al. 2018; Philippon 2019). This phenomenon can exacerbate inequality, since consumers are spread across the income distribution, while the shareholders who benefit are more likely to be near the top of the income distribution. Research has also shown that higher levels of market concentration are associated with workers receiving a lower share of the income generated by economic output (Barkai 2020; Autor et al. 2020; Eggertsson, Robbins, and Wold 2021).

Joining the two strands of the literature on market concentration, Qiu and Sojourner (2019) note how product and labor market concentration may interact. They use the example of a town with two nursing homes, which may be the only employers of nurses and the only providers of nursing care in the local market, giving them power in both the labor and product markets. They find that the negative effect of labor market concentration on wages is stronger in more concentrated product markets. Chapter 6 explores additional cases where varying levels of competition and market power at different points along the supply chain create similar dynamics, as discussed here in the context of labor market inequality.

**Racial and Gender Discrimination**

Racial and gender inequality can arise from discrimination that occurs both at the individual level and under broader, more structural conditions. This section explores the extensive evidence on how discrimination has exacerbated inequality, along with how such inequality can be sustained and worsened by employer market power.

Not all differences in earnings by race, ethnicity, and gender are the result of a lack of competition or discrimination, because they can emerge in competitive labor markets due to differences in characteristics such as educational attainment that enhance a person’s work productivity. There are notable disparities in educational achievement by race and ethnicity. For example, while 35.8 percent of white, non-Hispanic people have earned a bachelor’s degree, the shares are lower for Black (21.6 percent), Hispanic (16.4 percent), Native Hawaiian and Pacific Islander (17.8 percent), and American Indian and Alaska Native (15.0 percent) people (McElrath and Martin 2021). Asian Americans have the highest educational attainment, with 54.3 percent earning a bachelor’s degree or higher. There is a large literature on the extent to which differences in productivity-related characteristics, known as “human capital,” can explain racial and gender earnings gaps.

Residual gaps in wages and earnings by race, ethnicity, and gender remain even after accounting for differences in educational attainment and a wide range of other productivity-enhancing characteristics (Burnette 2017;
Kamara 2015; Borowczyk-Martins, Bradley, and Tarasonis 2017). For example, recent research finds that—even after accounting for factors such as education, occupation, work experience, and unionization status—40 to 60 percent of the gender wage gap remains unexplained (Blau and Kahn 2017; Foster et al. 2020). In fact, given that educational attainment of women is now higher, on average, than that of men, accounting for gender differences in education increases the unexplained portion of the gender wage gap. This unexplained portion is even larger for Black and Hispanic women, who face wage gaps that are greater than the sum of the gender wage gap and the racial wage gap. (Paul et al. 2018; Bahn and McGrew 2018). Moreover, while educational disparities can explain some of the differences in economic outcomes across racial and ethnic groups, these disparities can also result from discrimination that occurs before individuals enter the workforce.

Individual-level discrimination. One leading explanation for “residual” inequality is individual-level discrimination in labor markets on the basis of race or gender. A large literature in the field of economics homes in on two leading models of discrimination in the labor market, (1) so-called taste-based discrimination (Becker 1971), where some employers individually have a distaste for hiring workers of a certain group; and (2) statistical discrimination (Phelps 1972; Arrow 1973), which occurs when employers that do not have full information about a potential worker’s skills use the average characteristics of their racial or gender group to make wage offers (for a review of theory and empirical evidence, see Guryan and Charles 2013). Regardless of intent, both forms of discrimination have disparate negative effects on the group against which the discrimination is occurring.

These forms of discrimination in the labor market take place during individual transactions between workers and employers, and they are theoretically unlikely to persist in well-functioning markets. In the case of taste-based discrimination, differential treatment should decline as discriminatory employers are driven from the competitive market by those whose employment decisions reflect only the productive capacity of their workers. Meanwhile, statistical discrimination may potentially decline over time as employers gather more accurate information about workers (Altonji and Pierret 2001). However, Sarsons (2019) shows that this need not be the case, finding that after the death of a patient, female surgeons experience a greater drop in referrals from primary physicians than their male counterparts, which suggests that the same kind of information may be interpreted less favorably for women doctors as compared with men.

Evidence on individual-level discrimination by race or gender has been found through the use of experimental methods such as résumé studies, where résumés with identical qualifications, but with different racial or gender identities, are sent to employers. Bertrand and Mullainathan (2004)
find that résumés with white-sounding names were called back at a 50 per-
cent higher rate than those with Black-sounding names. Quillian and others
(2017) conducted a meta-analysis of all such experimental studies of racial
and ethnic discrimination, and find that white applicants got 36 percent more
callbacks than Black applicants and 24 percent more callbacks than Latino
applicants. The study also finds no change in the levels of discrimination
against Black applicants between 1990 and 2015, but a modest decline
in discrimination against Latino applicants. Related research focusing on
discrimination against Hispanic and Latino workers in the housing market,
which can reduce overall labor market mobility, finds that immigration and
assimilation play an important role. An experimental study using email cor-
respondence by Hanson and Santas (2014) finds that 6.9 percent of landlords
discriminate against seemingly recent Hispanic immigrants, with little to
no discrimination against applicants who appear assimilated, suggesting
significant barriers to mobility for marginalized Hispanic and Latino people.

Experimental studies also find individual-level labor market dis-
crimination against women. Qualified women are less likely to be hired or
promoted compared with men (for a case study of symphony orchestras, see
Goldin and Rouse 2000), and the hiring discrepancy is particularly strong
for positions where expected income is higher (Neumark et al. 1996). More
recent résumé studies shed light on how gender discrimination is concen-
trated among particular firms and is stronger in certain industries (Kline,
Rose, and Walters 2021), and find evidence that it can be particularly acute
among employers in male-dominated professions (Hangartner, Kopp, and
Siegenthaler 2021) and those seeking to fill jobs that require a major in
science, technology, engineering, and/or mathematics (Kessler, Low, and
Sullivan 2019).

Beyond individual-level discrimination: structural racism. A growing
body of research documents how theories of individual-level discrimination
are incomplete, particularly in explaining the persistent gaps in outcomes
between racial groups, because they do not adequately incorporate the
legacy of historic forms of discrimination in the United States. For example,
current Black/white gaps in economic outcomes can be partially explained
by periods throughout U.S. history ranging from the era of chattel slavery,
to Jim Crow regimes of segregation, to the present era of mass incarceration
(Cook and Logan 2020).

To establish a theory capable of explaining these persistent gaps,
William Darity Jr. developed the subfield of “stratification economics”
(Darity 2005; Darity, forthcoming; Chelwa, Hamilton, and Stewart, forth-
coming), in which he argues that economic gaps have persisted because
of the material incentive to maintain distinct group identities. With these
group identities in place and entrenched within a hierarchy, theories such as
Acemoglu and Wolitzky’s (2011) model of coercion can be used to show
how “structural” forms of racism can take hold in labor markets.¹ Under this
theory, employers have an economic incentive to coerce workers into unde-
sirable, low-wage work arrangements that maximize profits, in the extreme
using force or violence, or, under softer versions of coercion, weakening
workers’ bargaining power by limiting their mobility and outside options.
Naidu (2010) provides evidence of this, showing that enticement fines that
prevented employers in the postbellum U.S. South from recruiting already-
employed agricultural workers reduced the labor market mobility and wages
of Black sharecroppers.

A second key insight regarding structural racism is that discrimination
by a subset of actors can spill over to others in the same setting or market,
or in other parts of the economy, generating more pervasive disparities. For
example, discrimination in law enforcement and legal systems exacerbates
disproportionate rates of incarceration across racial groups. Though there
are 233 people in State or Federal prisons per every 100,000 white U.S.
residents, Hispanic people have a 50 percent higher rate, at 351 per 100,000,
American Indian and Alaska Native people have more than twice the rate, at
565 per 100,000, and Black people have nearly five times the rate, at 1,160
per 100,000. And though those who identify as Asian American alone have
a much lower imprisonment rate, of 39 per 100,000, people identified as
Native Hawaiian and Pacific Islander have a rate more than 12 times as high,
at 497 per 100,000 (Carson 2021). In addition, there is substantial evidence
of labor force discrimination against formerly incarcerated people, both due
to concerns about recidivism and gaps in work experience, and also due to
a general stigma above and beyond productivity-related factors (Agan and
Starr 2018). This discrimination is at times codified in restrictions that keep
them from working in certain sectors; a number of States deny occupational
licenses to those with a prior arrest or conviction (Sibilla 2020). Chapter 4
provides further detail on some of the obstacles that limit the employment
opportunities of formerly incarcerated people. Even if the barriers faced
by the formerly incarcerated were not racially targeted by design, higher
rates of incarceration for certain racial groups mean that these employment
barriers disproportionately block members of these groups, resulting in a
structural form of racial discrimination.

In some cases, the long-run impact of historical racial discrimina-
tion can result in economic indicators that might naively be interpreted as
evidence that discrimination has been overcome. Suzuki (1995) examines
the improvement in economic outcomes for Japanese immigrants between
1920 and 1930, as measured by a greater share employed in “professional”

¹ For further discussion of this application, see the notes on structural economic racism by Acemoglu
and Wolitzky (2011).
and higher-paid occupations during this period. These patterns are cited by some as an example of exceptionalism among Asian American families, which continue to have some of the highest levels of earnings among different racial and ethnic groups. Suzuki (1995) challenges this common narrative, pointing out that during that 1920–30 period, nine States passed laws banning the purchase of farmland by Japanese immigrants, the Supreme Court deemed Japanese people ineligible for naturalization as they were neither white nor of African descent, and the U.S. government passed a law excluding Japanese immigrants. The author also shows that the laws were associated with a significant return of these immigrants to Japan, and that this outflow was disproportionately made up of those in lower-earning occupations. Thus, the apparent economic success story of Japanese immigrants may have actually been driven by highly discriminatory policies that resulted in selection bias among those who remained here.

One of the most notable cases of historic economic stratification involves the widespread dispossession of land from indigenous people and nations during the expansion of U.S. territory that began in the late 1700s. Carlos, Feir, and Redish (2021) argue that though historians often highlight the key roles of abundant land, property rights, and the rule of law in U.S. economic development, these discussions erase the simultaneous erosion of these very same inputs and institutions for members of existing Native groups and entities. In addition to the direct types of harm caused by the often-violent process of relocation and geographic restriction, the centuries-long process helped give rise to adverse economic outcomes for present-day American Indians and Alaska Natives. As just one example, Akee (2020) studies the Nelson Act of 1889, which took collectively held property of the Minnesota Anishinabe reservations and allotted parcels to individual owners, allowing them to sell lands to non-Indian buyers (U.S. Congress 1889). While increased private ownership of land might be expected to support a more productive use of land, Akee (2020) finds, compared with reservations not affected by the allotment, a rapid reduction in land ownership, home ownership, and self-employed farming, along with an increase in renting and wage labor in the timber industry. These reductions in land and capital ownership likely resulted in lower wealth levels and poorer economic outcomes for subsequent Anishinabe generations.

Gender-based occupational segregation and bias. Beyond employer discrimination in hiring and promotion, economists have also considered broader sources of gender inequality in the labor market, such as occupational segregation and employers’ assumptions about the division of labor in the household. Occupational segregation plays a major role in the gender wage gap. Research finds that differences in the types of occupation and

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2 Although income itself may be considered a better measure, it was not captured by the Census surveys used for this analysis.
industries in which men and women work are some of the largest contributors to the wage gap, accounting for one-third to one-half of the gap (Blau and Kahn 2017; Foster et al. 2020). There is also evidence that the gender wage gap is linked to the disproportionate rewards for long hours and weekend work in some occupations (Goldin 2014; Foster et al. 2020). Although occupational segregation by gender has been decreasing over time, progress has stalled in recent decades (del Río and Alonso-Villar 2015). In the years 2011–15, more than 40 percent of workers were in occupations in which more than three-fourths of workers were of one gender, with women more likely to be in low-paying occupations (Gould, Schieder, and Geier 2016).

Women are more likely to enter occupations that entail caring for others. For example, 94 percent of workers in the childcare sector and 89 percent of workers in home health care are women; of those, Black, Hispanic, and Asian American / Pacific Islander women are overrepresented relative to their share in the overall workforce (Gould, Sawo, and Banerjee 2021). Average wages in these sectors are roughly half the average among workers overall. Furthermore, research has documented a wage penalty associated with certain caregiving occupations that persists after controlling for the education and skills required for these jobs (England, Budig, and Folbre 2002; Barron and West 2011; Pietykowski 2017; Budig, Hodges, and England 2019; Folbre and Smith 2017). This “care penalty” means that even highly skilled care workers may be paid less than they would be in jobs that require similar qualifications but do not involve caregiving. Estimates of the care penalty vary across studies, but the most comprehensive recent study finds a 15 percent wage penalty for female childcare workers, nursing aides, and health aides (Budig, Hodges, and England 2019). The study also finds a 6 percent wage penalty among men in these fields, consistent with other studies that find that the wage penalties in these caregiving occupations are not confined to women. Recent research has found evidence that stereotypes about gender-specific skills and gender-specific roles can explain at least some of this occupational segregation (Bertrand 2020; Levanon, England, and Allison 2009; Pan 2015). The predominance of women in relatively low-paying occupations translates into greater gender wage inequality.

Another source of gender inequality relates to the division of labor in the household, as well as employers’ assumptions about it. Though the increase in women’s labor force participation has been accompanied by a decrease in their average time spent on household labor (including housework and child care), research shows that women spend a higher fraction of their hours in unpaid family care and that men spend a higher fraction of their hours in paid work (Bianchi et al. 2012). In 2019, mothers spent almost double the amount of time as fathers caring for children in the household (BLS 2020). This is true regardless of a woman’s wages relative to those of her spouse, as Siminski and Yetsenga (2021) find even
at the extreme—where women’s wages are more than double those of their spouses—women do 44 percent more household work. A potential result of imbalances within the household is that mothers experience long-term wage penalties related to the reduction in labor supply and loss of work experience that occurs when a child is added to their household (Kleven et al. 2019).

In addition to the direct effect of this period of labor force exit on mothers’ long-term earnings, experimental evidence shows that employers’ expectations of women’s greater childcare responsibilities can influence women’s labor market outcomes. A résumé study modeled on the research of Bertrand and Mullainathan (2004) found that prospective employers were almost twice as likely to call back women without children as they were women with children, while their callbacks of men were unaffected by fatherhood status (Correll, Benard, and Paik 2007). Petit (2007) similarly uses a résumé study to find significant hiring discrimination against young women for high-skill positions in the French finance industry, where time off for dependent care may be particularly penalized.

**How Inequality Affects Economic Efficiency and Growth**

Although part of the motivation for addressing imperfect competition in labor markets and discrimination is rooted in the spirit of fairness and justice, there is also an important case to be made that such measures can contribute to overall economic output and growth. When the policies that reduce inequality also serve to curtail costly rent seeking, economic efficiency and productivity are improved. Similarly, when the inequality stems from barriers that have kept some from fully taking part in the economy, removal of these barriers supports economic growth.

**Monopsony Power Produces Inefficient Labor Market Outcomes**

As explained above, firms with monopsony power in the labor market can set lower wages and employ fewer workers than they would under more competitive conditions, contributing to wage inequality. These inefficiently low levels of employment also directly hurt economic output. A recent study estimates that monopsony power in the U.S. economy reduces overall economic output by 13 percent (Naidu, Posner, and Weyl 2018). In addition, noncompete clauses and no-poach agreements, along with nondisclosure agreements and pay secrecy practices, can harm workers throughout the wage distribution. By reducing competition among employers and limiting workers’ mobility, these restrictive employment practices reduce economic output and lower wages. This reduction in consumer demand will, in turn, create a drag on overall economic growth in the long term (Caldwell and Naidu 2020).
efficiency by preventing some workers from finding the job that best matches their qualifications.

**Discrimination Misallocates Talent and Suppresses Innovation**

A number of empirical studies argue that various forms of racial and gender discrimination can sideline talented workers, resulting in slower economic growth. For example, a recent study by Buckman and others (2021) estimates that if employment, education, and earnings were equalized across racial and ethnic groups over the period from 1990 to 2019, gross domestic product would have increased by $22.9 trillion. These gains emerge both by allowing current workers to fully realize their potential, and also by signaling a more reliable return to investments in skills among underrepresented racial groups, which yields growth in the future. Likewise, Hsieh and others (2019) show that increased access to high-income occupations for underrepresented groups, over the period from 1960 to 2021, accounted for 20 to 40 percent of growth in aggregate output. Bucknor and Barber (2016) estimate an $80 billion cost to gross domestic product due to lower levels of employment among those who are formerly incarcerated, which is in part driven by discrimination and disproportionately affects Black, Hispanic, American Indian, and Alaska Native communities. Finally, research by Cook (2014) finds that racist violence led to hundreds of fewer patents by African American inventors in the late 19th and early 20th centuries, and a study by Cook and Gerson (2019) shows how closing the gaps in patenting for women and underrepresented minorities can increase economic growth.

As a concrete example, research shows that alleviating entrenched racism in the South was associated with greater regional economic growth. The brief period of increased Black political power in the South during Reconstruction saw increases in taxation and spending on public education (Logan 2020). Likewise, the Great Mississippi Flood of 1927, which forced the migration of Black workers to industrial cities and reduced the coercive powers of southern landowners, resulted in a greater reliance on capital investment and technology adoption (Hornbeck and Naidu 2014) in the region. Subsequent economic growth in these regions suggest that private gains from coercive labor practices had come at the expense of more socially valuable investment and efficient production. Most notably, Wright (2013) argues that the revolutionary changes brought about by the Civil Rights Movement led to improvements in access to jobs, education, and health care that yielded benefits not only for Black southerners but also for the entire southern economy, helping to partially undo decades of underdevelopment. Overall, the moments in history where entrenched racism in the South was partially dislodged have tended to be times where the region has best been able to catch up with the more industrialized northern economy.
Discrimination Reduces Incentives for Human Capital Investment

Discrimination and monopsony power can also have large, long-term negative effects on economic growth if they reduce the extent to which the affected individuals invest in their education and skill development. A worker who expects to be paid a wage lower than their productivity, whether due to discrimination or an employer’s monopsony power, may have less incentive to engage in activities like training that could increase their productivity, compounding already-existing barriers to such training. For example, in one study, Latina high school students who anticipated future career barriers due to their immigration status were found more likely to plan to attend a two-year college than a four-year college (McWhirter, Ramos, and Medina 2013). The benefits of greater human capital development for economic growth are discussed in more detail in chapter 4.

Policies to Address Sources of Labor Market Inequality

Addressing inequality is important for ensuring that people are rewarded fairly for their efforts and contributions to productivity as well as for fostering stronger productivity and growth. Because this occurs in so many ways, there are no one-size-fits-all solutions. Instead, there are a number of specific policies designed to address the inequality that stems from noncompetitive and discriminatory market outcomes, as well as policies that address larger, structural problems.

Core to addressing inequality is increased enforcement of current labor protection and antidiscrimination laws. The 1935 National Labor Relations Act (U.S. Congress 1935), which established the National Labor Relations Board; the 1938 Fair Labor Standards Act (U.S. Congress 1938), which led to the Wage and Hour Division at the Department of Labor; and the 1964 Civil Rights Act (U.S. Congress 1964), which established the Equal Employment and Opportunity Commission, are each important to ensuring that workers are treated fairly. More recent policies, such as the Americans with Disabilities Act of 1990 (U.S. Congress 1990) and the Family and Medical Leave Act of 1993 (U.S. Congress 1993), have focused on particular equity concerns. The proposed Equality Act, if passed, would prohibit additional forms of discrimination, including on the basis of sexual orientation and gender identity in settings beyond the realm of employment (U.S. Congress 2021e).

Research on the effects of laws prohibiting discrimination against workers generally finds positive effects on outcomes for the intended beneficiaries (for studies of specific groups, see Collins 2003; Neumark and Stock 2006; and Neumark et al. 2019). These results also underscore the need to address workers’ misclassification, whereby workers who should be
classified as employees, and therefore receive coverage of the above laws, are instead treated as independent contractors. More general economic policies have the potential to further counteract the forces that underlie wage inequality and racial/gender discrimination. Though far from an exhaustive list, this section surveys several such policies.

**Promoting Competition**

Healthy market competition is fundamental to a well-functioning U.S. economy. Basic economic theory demonstrates that when firms must compete for customers, it generally leads to lower prices, higher-quality goods and services, greater variety, and more innovation. In 2021, President Biden signed the Executive Order on Promoting Competition in the American Economy, establishing a multiagency approach to push back on decades of decline in competition. The Executive Order not only calls on the traditional antitrust agencies—the Department of Justice (DOJ) and the Federal Trade Commission (FTC)—to enforce existing laws vigorously and to consider updating their merger guidelines; it also directs all agencies and departments to use their detailed knowledge and expertise to ensure that their work clearly supports competition in the markets they regulate (White House 2021c). This whole-of-government approach is designed to address the concern that antitrust agencies are limited both by resources and the current judicial interpretation of the antitrust laws. It also relies on the fact that Congress has delegated authority to police anticompetitive conduct and oversee mergers to many agencies—not just the DOJ and the FTC. The Executive Order therefore directs or encourages roughly a dozen agencies to engage in more than 70 specific actions that will remove barriers to entry and encourage more competition.

Increased enforcement of antitrust laws would also alleviate labor market monopsony and therefore its negative effects on wages, equality, and race- and gender-based pay gaps (Marinescu and Posner 2019). Antitrust law has been used to combat no-poaching agreements, noncompete agreements, and related contractual restrictions on workers’ mobility. It can also be used to block mergers that would concentrate labor markets excessively and to penalize large employers that use illegal methods to obtain or maintain labor monopsonies. Though some of these uses of antitrust law have been rare until recently, the Executive Order on Promoting Competition calls for agencies to make greater use of antitrust law to promote competition in labor markets. For example, the DOJ and the FTC have begun the process for revising the merger guidelines, and have called for public comment on labor market implications (Federal Trade Commission 2022).
Unions and Labor Market Equity

Unions can provide workers the increased leverage to bargain with their employer, serving as a counterweight to the power that employers have to set wages and working conditions. Numerous studies support this notion, including research showing that unions’ negotiating power increases wages (Card 1996; Chava, Danis, and Hsu 2020), and that union representation also increases worker satisfaction and job tenure (Freeman and Medoff 1984). Unions also give workers a voice, which can improve productivity (Cai and Wang 2020). In the presence of employer monopsony power, the compensation gains achieved by unions may shift economic rents from employers to employees, reducing inequality without significant efficiency costs. Consistent with this view, higher rates of unionization have been shown to mitigate the negative effect of monopsony on wages (Benmelech, Bergman, and Kim 2020; Qiu and Sojourner 2019; Prager and Schmitt 2021; Dodini, Salvanes, and Willen 2022), and there has been, historically, an inverse relationship between the degree of union membership and income inequality (Farber et al. 2021).

Unions also have the potential to foster equitable pay and working conditions for people of different genders and racial and ethnic backgrounds. For example, higher rates of union membership among Black workers have led to increased wages; and, for Black women, have led to a substantial reduction in the gap in their wages relative to white women (Rosenfeld and Kleykamp 2012). Also, collective bargaining is associated with lower gender wage gaps among teachers (Biasi and Sarsons 2022). This has not always been the case in U.S. history: some unions have, in the past, supported exclusionary, anti-Asian immigration policies (Frymer and Grumbach 2020), and major unions have at times faced criticism for discriminatory practices against Black workers (Hill 1959) or limited representation of women among leadership roles (Ledwith 2012). Nonetheless, labor unions were important proponents of the Civil Rights Act of 1964 (Collier and Grumbach 2022), and later waves of unionization in the United States have been associated with greater representation for women in these organizations (Milkman 1990). In 2021, union membership was quite diverse; more than a third of unionized workers are Black, Hispanic, Asian, or members of another nonwhite group, and almost half are women (BLS 2022b). And among white workers, Frymer and Grumbach (2020) find that union membership leads to lower racial resentment and greater support for policies that benefit African Americans.

Despite declining union membership since the 1960s, almost half of nonunionized workers report interest in joining a union if one were available at their workplace (Hertel-Fernandez 2020), suggesting that there is a valuable role for policy efforts that support the right to union organizing. To
support these efforts, President Biden signed Executive Order 14025, which established the Task Force on Worker Organizing and Empowerment (White House 2021d). The Task Force, charged with identifying how the executive branch could support worker power and collective bargaining, released 70 recommendations focusing on how the Federal government can serve as a model employer and support workers by sharing information and improving transparency when it comes to organizing rights (Harris and Walsh 2022). In addition to the executive branch’s efforts, key legislation related to worker empowerment includes the Protecting the Right to Organize (PRO) Act (U.S. Congress 2021a). The PRO Act aims to protect workers’ right to join a union by introducing penalties for companies that violate workers’ rights, expanding workers’ collective bargaining rights, and ensuring access to fair union elections. The Public Service Freedom to Negotiate Act (U.S. Congress 2021b) similarly provides support to workers in the public sector, while the National Domestic Workers’ Bill of Rights (U.S. Congress 2021c) proposes to expand coverage of labor protections to domestic workers, providing greater regulation of labor standards for a sector that is disproportionately home to women, workers of color, and immigrants.

**The Minimum Wage**

The Fair Labor Standards Act was first signed into law over 80 years ago, and subsequent amendments have extended coverage to a broader range of workers. In addition, 30 States and the District of Columbia currently have a minimum wage that is higher than the Federal minimum (Department of Labor 2022b), and 40 localities have adopted minimum wages above their State minimum wage (Economic Policy Institute 2022). Mandating a minimum wage can decrease inequality by ensuring that those with the least earnings potential receive at least a minimum level of compensation for each hour they work. The potential for minimum wages to—on net—make low-paid workers better off depends on several factors, including whether employers have to compete for workers. A minimum wage could cause employers in a perfectly competitive labor market to cut back on hiring workers at the higher hourly rate. However, when workers’ wages are low due to a lack of competition or discrimination, minimum wage legislation may not be distortionary because employers are setting wages lower than a worker’s productivity and hiring fewer workers than they would under more competitive conditions. Though debate continues on the employment effects of minimum wage laws (Neumark and Shirley 2021; Dube 2019; Cengiz et al. 2019; Card and Krueger 1994), recent empirical evidence indicates that they do not materially reduce employment in concentrated labor markets and may even increase employment as market concentration increases (Azar et al. 2019). This suggests that policies like the minimum wage can reduce
wage inequality without reducing employment or sacrificing economic output.

The minimum wage has been shown to reduce inequality by increasing growth in earnings, with effects that persist over several years (Rinz and Voorheis 2018). When the Fair Labor Standards Act was amended in 1966 (U.S. Congress 1966) to extend Federal minimum wage coverage to some of the country’s lowest-paid sectors, wages increased and racial earnings gaps were reduced (Bailey, DiNardo, and Stuart 2020; Derenoncourt and Montialoux 2021). Derenoncourt and Montialoux (2021) estimate that the minimum wage law accounted for 20 percent of the reduction in the Black/white earnings gap during the Civil Rights Era.

Although legislation is required to increase the Federal minimum wage from its current level of $7.25 per hour, the Biden-Harris Administration’s Executive Order 14026 establishes a new hourly minimum wage of $15.00 for workers performing work on or in connection with covered Federal contracts (White House 2021e). In addition to directly lifting the wages of hundreds of thousands of contract workers, this Executive Order could have broader effects, as competitors in the same labor markets as Federal contractors may increase wages, too, as they seek to compete for workers (Derenoncourt et al. 2021). In addition, President Biden has endorsed several other adjustments to minimum wage policy, including raising the Federal minimum wage to $15 for all workers, indexing future increase to inflation, phasing out the lower minimum wage that applies to some workers who receive tips, and expanding coverage of the Federal minimum wage to teens and workers with disabilities, all of which are features of the proposed Raise the Wage Act of 2021 (U.S. Congress 2021d).

**Full Employment and Tight Labor Markets**

Although minimum wage legislation and support for unionization efforts can directly help to reduce overall wage inequality, fiscal and monetary policies to support full employment conditions can play a strong underlying role as well. Full employment—the lowest rate of unemployment possible without spurring inflation—can put workers in a position to demand pay increases in accordance with their productivity. This can both offset the market power of employers and limit their ability to engage in discriminatory practices. When the number of job openings relative to workers seeking jobs is high, there are improved outside options for all workers, which may be especially important for those subject to discrimination. For example, the American Rescue Plan, crafted both to address the COVID-19 pandemic and support the economy, contributed to much higher growth than anticipated, with over 6 million jobs added to the U.S. economy in 2021, the largest percentage rise during a calendar year since 1978. However, the world has learned
that expansionary fiscal policy can become challenging when the supply of goods and services is constrained, as has been the case during the pandemic.

Research by Dahl and Knepper (2021) supports the idea that full employment can protect workers from discriminatory practices. They find that tighter labor markets and more generous unemployment insurance benefits, which allow job seekers greater ability to search for jobs, increase the reporting of sexual harassment by workers who may otherwise avoid reporting out of fear of retaliation. Beyond the substantial moral considerations, policies that support tighter labor markets and help limit gender discrimination in the workplace may also improve economic efficiency by allowing bad actors to be identified and held accountable, rewarding good employers, and ensuring better matches between employers and employees. Dahl and Knepper (2021) find similar evidence from discrimination claims that tighter labor markets reduce age-related discrimination.

There is also evidence that tighter labor markets can reduce the gender wage gap, as shown by Biddle and Hamermesh (2013). In contrast, however, the authors find that Black/white gaps in wages are actually larger during tighter labor markets, though that may be partially due to the fact that more low-wage Black workers are able to enter the workforce when unemployment is low (Ashenfelter 1970; Freeman et al. 1973). Indeed, other research finds that the Black/white gap in unemployment tends to fall during tighter labor markets (Rodgers 2008; Hoyes, Miller, and Schaller 2012; Cajner et al. 2017). This smaller Black/white gap in unemployment during tight labor markets does not appear to operate through lower levels of racial discrimination in callbacks to job applicants, however. A number of résumé studies have shown that the gap in callbacks between these groups persists through periods of both high and low unemployment (Bertrand and Mullainathan 2004; Nunley et al. 2015; Quillian et al. 2017).

**Care Economy Policies**

The provision of affordable childcare and early childhood education in the United States has the potential to reduce gender wage inequality by helping to support the paid labor force participation of women in families with children and reducing care-related discrimination by employers. The pandemic highlighted the importance of the availability of care, as school and childcare closures exacerbated existing shortages in the availability of care (Carson and Mattingly 2020). Childcare and universal preschool can ease the trade-offs that families with children must make between care responsibilities and paid work. But many families find the prices for high-quality childcare and early childhood education on the private market unaffordable, and credit constraints may keep them from accessing needed childcare at a time in their lives when their earnings and savings are lowest.
Subsidizing childcare and providing universal public preschool, therefore, can help many families access otherwise unaffordable options. In addition, there may be positive economic spillovers that parents do not completely factor in when deciding whether to purchase childcare or early childhood education. As discussed in chapter 4, high-quality childcare provides long-lasting benefits for children, especially those who are more economically disadvantaged (Herbst 2017), thereby benefiting the rest of society by fostering economic growth. Moreover, viable options for childcare and preschool, by providing parents with the option to remain in the paid workforce, can mitigate the motherhood penalty associated with a labor force exit and reduce the likelihood of employer discrimination related to expectations of childcare responsibilities that arise even for women without children.

Much research on past childcare and preschool programs has found positive effects on maternal labor force participation and household income (Blau and Kahn 2013; Davis et al. 2018; Herbst 2017; Morrissey 2017; Bauernschuster and Schlotter 2015; Wikle and Wilson 2021). Olivetti and Petrongolo (2017) examine cross-country differences and find that the provision of early education and childcare are particularly beneficial to women’s employment and earnings. In contrast, Kleven and others (2021) find that the expansion of parental leave and subsidized childcare in Austria had no effect on gender inequality in the labor market. This suggests that the provision of generous family policies is necessary, but not always sufficient, to reduce motherhood penalties in the labor market. Whether or not they are sufficient to reduce motherhood penalties, generous family policies do allow parents to ensure that their children will receive high-quality care while they have the option to participate in the labor force.

In addition, policies that support the care industry also have the potential to disrupt the “low road” equilibrium of low wages and difficult working conditions in this sector. Subsidies that bolster the wages of childcare workers, one of the lowest-paid occupations in the U.S. economy, can increase their earnings and expand employment. Moreover, given that the care sector is home to a disproportionate share of women—especially Black, Hispanic, and Asian American and Pacific Islander women—childcare subsidies can also directly reduce both gender and racial wage inequality.

Another policy that could help families manage care responsibilities is the establishment of a national paid family and medical leave program, building on the 1993 Family and Medical Leave Act, which requires covered employers to provide employees with 12 weeks of unpaid leave to care for a new child, care for a seriously ill family member, or recover from the worker’s own serious illness. Paid family and medical leave programs have been enacted in nine U.S. States and the District of Columbia (Kaiser Family Foundation 2021). Paid leave used at the time of the birth of a child has been
shown to increase the mother’s attachment to the labor force (Byker 2016; Rossin-Slater, Ruhm, and Waldfogel 2013), which can potentially increase long-term earnings. Along with other policies that maintain their labor force participation, moderate lengths of parental leave can reduce motherhood wage penalties (Budig, Misra, and Boeckmann 2016). Paid leave may also produce labor supply benefits when used for other purposes, such as caring for a spouse with a work-limiting disability or a chronic health condition (Anand, Dague, and Wagner 2021).

The structure of parental leave in the United States differs markedly from that of other countries, where parental leave is often tied to a child, and family members can choose who takes the leave. In contrast, leave in the United States is tied to the worker, and cannot be transferred between family members. This means that parents of a new child can maximize their combined parental leave by having more than one parent take it. This nontransferable leave has the potential to reduce care-based discrimination against women by creating an incentive for both men and women to use it. Research has shown that when other countries have introduced policies designed to increase fathers’ use of parental leave, the labor supply and earnings of mothers have increased, though the persistence of the effects has varied (Dunatchik and Ozcan 2020; Druedahl, Ejrnaes, and Jorgensen 2019). Such policies have also had positive health effects on mothers as well as long-lasting effects on the division of labor in the household (Patnaik 2019; Persson and Rossin-Slater 2019).

**Progressive and Equitable Tax Policy**

A progressive system of taxation, where higher-income households pay a greater share of their income in taxes, can play an important role in reducing inequality, including that which is driven by differences in skills and luck, or other forces that remain even when barriers to competition have been addressed. Figure 5-6 demonstrates how the combination of means-tested transfers and Federal income taxes increased incomes of the lowest quintile by 68 percent, and reduced incomes in the highest quintile by 24 percent. Using an alternative summary measure of income inequality, the Gini coefficient was reduced by 8 percent by taxes and transfers in 2018. And given that white women and Black, American Indian, Alaska Native, and Hispanic people of any gender are overrepresented in the low-wage workforce, progressive taxation can also reduce racial, ethnic, and gender inequality.

Tax credits that provide direct transfers to middle- and lower-income households can support the goals of reducing inequality and enhancing equity. The Child Tax Credit has emerged as a key lever in this area. While this credit traditionally accrued to largely middle-income households, the American Rescue Plan Act temporarily increased the credit and made it fully
refundable in 2021, allowing all households at the lower end of the income distribution to receive the maximum credit, even if they had no tax liability. The most direct impact of these changes was to reduce poverty, especially for children in recipient households, with the greatest estimated reductions in poverty for Black and Latino children (Center on Poverty and Social Policy 2021). These credits also support investments in human capital, such as educational attainment, as discussed in chapter 4, and the associated long-run increases in employment, earnings, and longevity.

A key challenge to progressivity is the preferential tax treatment of capital income—such as dividends generated from an investment or the gain in the value of stocks or other assets (Tax Policy Center 2020). Capital income is generally taxed at lower rates than wage and salary income, and the increase in the market value of stocks and many other assets is not taxed until the gain is “realized” when the asset is sold. Thus, these capital gains are allowed to accrue and compound for years before being taxed, and, if passed on at death without being sold, the gains in the value of the asset over the lifetime of the holder will escape taxation completely. Recent research shows that when capital income is instead counted as income in the year it accrues, the 400 wealthiest households pay between 6 and 12 percent of their income in taxes (Leiserson and Yagan 2021). This is a much lower rate than would be paid by households that had received all their earnings through labor income, and because capital income is concentrated among higher income households, these factors tend to exacerbate inequality in after-tax income.
In addition, households with significant capital income are more likely to get away with tax evasion. It is estimated that nearly 99 percent of income taxes on labor wages and salary are paid, while a much lower percentage of taxes owed are collected on the forms of income, such as short-term capital gains, that are more likely to be accrued by higher-income households. (U.S. Department of the Treasury 2021c; Internal Revenue Service 2019). Recent research suggests that highly sophisticated forms of tax evasion, including through offshore accounts and pass-through businesses, go undetected and account for nearly one-third of evasion (Guyton et al. 2021). Moreover, while audits by the Internal Revenue Service (IRS) have decreased in general in recent years, they have decreased more rapidly among higher-income earnings, skewing enforcement toward a group with lower rates of underpayment (Sarin 2021). One reason for a decline in audits among higher-income taxpayers is that audits among this group are costly—they have access to advanced forms of evasion—and the IRS has been underfunded during the last decade.

Policies that achieve greater parity in tax rates on capital income relative to labor income, and greater funding for the IRS to enhance taxpayer compliance, can therefore improve the progressivity of the tax code. This includes taxing capital income at ordinary income tax rates and taxing the capital gains on assets transferred at death, both of which were proposed, with some progressive exclusions, as a part of the revenue policies in President Biden’s Fiscal Year 2022 budget (U.S. Department of the Treasury 2021a). On the tax compliance side, this budget also outlined a number of improvements to the IRS’s enforcement capability, including additional funding to help combat sophisticated forms of tax evasion, better information from third-party reporters on capital income, technological upgrades at the IRS, and improved regulation of paid tax preparers. This combination of policies would likely increase the effective tax rate faced by those with capital income, which, given the concentration of capital income among the richest households and the underrepresentation of marginalized groups among this category, would facilitate greater progressivity and racial and ethnic equity in the tax code.

Conclusion

This chapter has explored and defined the scope of forces that keep labor and product markets from being truly competitive, and that prevent individuals from reaching their full potential. These include a lack of competition in markets affecting a broad range of workers, and racial and gender discrimination more specifically. The costs of ignoring these structural forces are increased inequality and reduced economic growth and output. These societal and economic costs stem from inefficient labor market outcomes,
misallocated talent, suppressed innovation, and reduced incentives for human capital investment. Government actions can curtail these forces by enforcing existing antidiscrimination laws and promoting competition in the economy—at large, and in labor markets in particular. Policies that establish a minimum wage or protect the rights of workers to join a union are examples of actions that counterbalance employers’ market power, while government support for the care economy can bolster wages and increase employment in that sector. These and other policies can begin relieving the historical burdens on disadvantaged groups of workers, helping to reduce inequality and bolster economic output and growth.
### Chapter 5


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