Toward an (Austrian) Economics of Discrimination

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Abstract

The Austrian School is known for many unique contributions to economics. Despite this, there has been little said about issues of race and ethnicity. This paper seeks to fill that gap. In it, I develop a general Austrian theory of racial discrimination as it occurs in the labor market. I posit that racial discrimination can be framed as a Hayekian knowledge problem. The theory is then followed by and compared to empirical evidence from both economics and sociology. Implications are drawn as it relates to network theory and further topics for research are suggested.

Keywords: Austrian economic; racial discrimination; networks; segregation; affirmative action

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Introduction

In 1957, Gary Becker wrote what many consider the seminal book on the economics of racial discrimination. Becker posited that in a market economy where certain employers have what he called a "taste for discrimination" they would tend to be outcompeted by other employers who had no such taste and thus lower labor costs. In short, racial discrimination would be penalized in a free market.

American race relations have come a long way since economists first started examining the economics of race. The wage gap between black and white workers now shrinks considerably when adjustments are made for differences in human capital (Johnson and Sell 1976; O'Neill 1990; Johnson and Neal 1996). Still though, absolute wage and employment inequalities still exist between black and white workers which must be explained. Glenn Loury (1998) goes so far as to argue that demand-side racial discrimination based on tastes is no longer the primary problem. Instead, we need to move beyond that and look at the racial dimensions of the supply side factors, such as the skills gap and the role of networks in perpetuating black/white inequalities.

So what does Austrian economics have to say about this? The answer is almost nothing. The author could find only two references to Austrian economics and racial discrimination. The first is found in the *Elgar Companion to Austrian Economics* (Walker 1994), but only deals with racial discrimination from the perspective of a taste for discrimination and statistical discrimination. The other reference actually comes from two Marxist economists (Darity and Williams 1985) who come much closer to what this author has in mind, but who quickly dismiss the Austrian theory of discrimination before it is born.

In light of this, I intend to formally develop an explicitly Austrian theory of racial discrimination. Specifically, I focus on labor markets where racial discrimination has its most deleterious effects from a normative perspective. Following Loury (1998), I focus not on discrimination stemming from tastes or statistical differences, but rather from a Hayekian knowledge problem in which Kirzner's (1973) famous entrepreneur plays a role in alleviating (but sometimes exacerbating) the problem of discrimination in labor markets.

This paper is broken down into several sections. Section one looks at the various neoclassical theories of racial discrimination and is followed by what I hope is a distinct Austrian theory of discrimination. Section two looks at the empirical evidence on labor markets. Section three examines the rise of "embeddedness" theories and their relation to the Austrian theory. Lastly, section four concludes by looking at the theory's implications and areas that call for further study by Austrian economists.

1. Discrimination in the Neoclassical and Austrian Frameworks

One of the first scholars to seriously look at racial discrimination from an economic perspective was Nobel Laureate Gary Becker in his famous 1957 book *The Economics of Discrimination*. Utilizing the neoclassical framework, Becker hypothesized that racial discrimination arose from what he called a "taste for discrimination." (Becker 1957) Individuals are said to have a taste for discrimination when they are willing to incur a cost in order to avoid interaction with members of a certain group. This cost for discrimination arises for several reasons. The first is that race is a non-pecuniary characteristic in terms of output because blacks and whites are assumed to be perfect substitutes for each other. The color of one's skin has no effect on their productivity, so a black worker is just as good as a white worker. Given that they are each equal, an individual who wishes to indulge in his taste for discrimination will be paying extra for his preference by foregoing additional profit.

For an employer with a taste for discrimination, this means two things. 1.) He has fewer workers from which to choose and 2.) The price for labor goes up (ceteris paribus) because there are fewer people competing for the same job. Higher wages for the worker means higher costs for the employer. Depending on whether the industry in question is more capital or labor intensive, the costs of discrimination will vary. Since the discriminating employer is paying a higher wage rate than the non-discriminating employer, the employer who does not discriminate will tend to have lower costs and possibly drive his discriminating competitor out of business.[1]

The persistent racial inequalities that followed in the wake of the civil rights movement which changed the legal and social environment of American race relations caused economists to look for additional sources of racial discrimination in job markets. Edmund Phelps (1972) developed a theory of statistical discrimination in which he eased the neoclassical assumption of full information. In his model, employers do not have full information on prospective employees. If the employer believes that black workers, on average, tend to be less productive than white workers then they will use race as a proxy for productivity and discriminate against black workers. Phelps's model does not require the same taste for discrimination as Becker. Whether the employer bases his opinion on false stereotypes or an understanding that productivity differences stem from past discrimination, the results are the same.

Following Phelps, Michael Spence (1973) made an additional contribution with his work on job market signaling. In his model, prospective employees can signal their productivity (i.e. through educational achievements) to employers with limited information and make themselves stand out in the crowd. While workers can invest in signals, Spence notes other characteristics, such as race, cannot be changed and labels them indices. If signals attached to different indices come to be judged separately by employers in the feedback loop of iterated market interactions then we can get two different equilibria where black workers get caught in a lower equilibrium trap. Due to the fact that black workers are judged more on their race, they invest less in education because the expected returns are now lower. This "vicious cycle" then persists for endogenous reasons. Aigner and Cain (1977) tweak the assumptions of both Phelps and Spence, but come away with more or less the same conclusions.

Cornell and Welch (1996) find that even when employers have no racial preferences and employee group characteristics do not differ, racial discrimination can still occur because employers are better able to judge the characteristics of applicants from the same background as themselves. Norman (2003) looks at the efficiency of racial discrimination from the viewpoint of a central planner and finds that it would persist. Borjas and Goldberg (1978) assume that black and white workers could have all the same qualifications, but a biased employment test could lead to wage inequality. In each and every one of these models, racial discrimination persists on its own in a competitive market.

Coate and Loury (1994) argue that part of it is a collective action problem: "Even if they all recognized the mechanism at work here, no single employer could reduce group productivity differences by altering his own assignment strategy. The action of a single employer will not affect investment incentives when workers do not know with which employer they will be matched." Therefore, according to Coate and Loury, government intervention is warranted.

The last possibility for the persistence of racial discrimination comes from Lang (1986). Rather than arguing that employers discriminate because of a taste or for statistical reasons, Lang uses a sociolinguistic explanation. In his model, blacks and whites speak different languages, by

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[1] Akerlof (1976) argues that taste-based discrimination could persist in certain situations, but see Roback (1989) for a convincing critique of Akerlof.

which he means both verbal and nonverbal modes of communication, and this acts as a barrier to interaction between the two groups. The high cost of communication leads to segregation in most cases and lower wages for the minority group when interactions do take place.

Despite the differences in each of these models, they have two things in common: The first is that all of them find that racial discrimination will persist in one way or another. Secondly, they all make a very important assumption. Whether actors in the models have no knowledge or partial knowledge, every single model assumes homogenized beliefs among employers with no room for local knowledge. This leaves them open to an important critique from economists of the Austrian school who rely on a slightly different framework for analyzing market interactions.

Knowledge played a very special role for Friedrich Hayek. In fact, he characterized it as *the* central problem of economics as a social science (Hayek 1948). In contrast to the neoclassical assumption of perfect knowledge, Austrians put an emphasis on the division of knowledge in society. Hayek was concerned with the kind of knowledge which "by its nature cannot enter into statistics and therefore cannot be conveyed to any central authority in statistical form." This is what he called the knowledge of the "particular circumstances of time and place".

Particularly relevant to our discussion of racial discrimination is Hayek's work on cognitive psychology. Hayek wrote the manuscript for *The Sensory Order* as a young student, but it was not actually published until 1952. In it, he argues that the mind is a kind of system of classification. People make mental maps based on experiences and these maps evolve as we gain new knowledge. While he never explicitly wrote on the racial discrimination, his ideas can be applied to the problem. In fact, much of the research on stereotyping that has taken place in modern cognitive psychology fits into Hayek's framework (Hamilton 1981; Brewer and Kramer 1985; and especially Anderson, Fryer and Holt 2006). In so far as racial discrimination is a Hayekian knowledge problem based on limited and incomplete information of prospective employees in the labor market, the Austrian theory of discrimination is consistent with the literature on statistical discrimination. It is the assumption of homogenous beliefs and knowledge that really undermines the neoclassical theory.

The neoclassical homo economicus is an economizer. He is given his means (selection of employees under uncertainty) and ends (a profit motive and certain tastes). This leaves no room for entrepreneurship (however defined) in neoclassical models. "The theoretical firm is entrepreneurless," remarked Baumol (1968) "the Prince of Denmark has been expunged from the discussion of Hamlet." Additionally, This leaves no room for knowledge creation.[2] It is the entrepreneur who makes all the difference in the analysis of racial discrimination. The Austrian conception of the entrepreneur is much more helpful. Specifically, the entrepreneurial function as envisioned by Mises and Kirzner is especially relevant to the topic here.[3] Mises (1949) described the entrepreneur as the individual who is the "first to understand that there is a discrepancy between what is done and what could be done." In contrast to homo economicus, Mises's homo agens or acting man actually manipulates his given means as well as "the very perception of the means-ends framework within which allocation and economizing is to take place." Homo agens possesses "alertness toward fresh goals and the discovery of hitherto unknown resources" (Kirzner 1973). It is the entrepreneur, possessing superior knowledge of labor market participants, who makes a profit by hiring the undervalued workers overlooked by his

[2] For example, in Stigler's (1961) model, the actor does not create knowledge, but again is simply a manager who decides how much to invest in the search for knowledge.
[3] For a wider survey of Austrian theories of entrepreneurship, see Klein (2008).

discriminatory competitors. Kirzner is vague in regard to what entrepreneurial alertness might look like in the real world, so it would be best to examine the empirical evidence in order to explore the idea further.

Discrimination can take place at several points within the context of the labor market. Doeringer and Piore (1971), identify at least three ways in which discrimination can manifest itself. The first is at the entry phase where certain hiring standards, screening criteria, and recruitment methods can have different effects on different racial groups. The second is in internal allocation where different groups are put onto different promotional tracks under different promotional standards. The third is in wages where simple wage inequality can be found between groups. Each of these is discussed at some point in the next section.

2. Empirical Evidence of Discrimination in Labor Markets

Economics and Sociology have both developed numerous approaches to measure labor market discrimination. In addition to the classic econometric estimate, other approaches include experimental economics, audit studies, and in depth interviews. The results tend to be diverse as different methods tend to focus on different aspects of the process and different measurements of the outcome.

While some studies deny any racial wage differences in the first place after proxies for human capital are taken into consideration (Johnson and Sell 1976; O'Neill 1990; Johnson and Neal 1996), other studies that look at less aggregated data usually find some level of racial disparities.

Altonji and Pierret (2001) look at both the effects of statistical discrimination and employer learning on wages. Utilizing data from NLSY79, a nationally representative sample of 12,686 young men and women who were 14-22 years old when they were first surveyed in 1979, they find evidence of statistical discrimination in wages when employees first hit the job market. As employers learn more information about employees though, the wage becomes more dependent on productivity and less dependent on easily observable characteristics. This is consistent with the idea wage disparities stem from a lack of information and entrepreneurial learning takes place as employers discover the true worth of employees.

Experimental approaches are often a good way to measure levels of discrimination because experiment designers possess some control over the variables in the experiment. In a natural experiment, Golden and Rouse (2000) use changes in the auditioning procedures of symphony orchestras to test for sex discrimination. Between 1950 and 1980, many orchestras began to use blind tests by putting up a physical screen between applicants and jurors at different levels of the audition process. With some caveats, they found that the use of a screen increases the probability that a woman will advance further in the process and be hired.

Fershtman and Gneezy (2001) use three experimental games (trust game, dictator game, and ultimatum game) in order to reveal student preferences about other ethnic groups in Israeli society. In all three games, the authors found widespread mistrust and stereotyping of Eastern Jews (who tend to be Asian or African and poorer) by Ashkenazic Jews (who tend to be European and wealthier). Again though, as Axelrod (1984) has shown, learning and trust tends to evolve over time as the parties learn more about each other.

Audit studies are another popular attempt to control for variables thought to have an effect on the outcome. These studies use real people who are matched as "perfect substitutes" and sent out to apply for the same job. Raich and Rich (2002) list of comprehensive review of labor market audit studies and the majority find some evidence of racial discrimination by employers. The reader must use some caution interpreting the results of audit studies though for the multitude of reasons Heckman (1998) points out. A recent exception might be Bertrand and Mullainathan (2004). They responded to help wanted ads with fictitious resumes which either had a "black sounding" name or a "white sounding" name. They found that even with equivalent credentials, the white sounding names were much more likely to get a call back across all industries, credential levels, and residences. A notable caveat though is that black female names not normally associated with a lower socioeconomic status (Ebony and Latonya) received the same number of responses, on average, as the white names. Additionally, Fryer and Levitt (2004) found distinctly blacks names associated with young, poor, lower education, single mothers and find no negative correlation between black names and later life outcomes Again, we should not be surprised given the limited information employers have about applicants. They discrimination when they have limited information, but not when they have fuller information.

In depth employer interviews might be the best way of exploring the racial biases of employers. Compared to the aforementioned studies which follow the job applicant, these studies focus primarily on the employer's behaviors so causal ambiguity is less of a problem. In each case, the investigators all find some sort of racial discrimination taking place. Wilson (1996) finds widespread discrimination against young black males in Chicago based on employer perceptions of their work ethic. Neckerman and Kirschenman (1991) come to the same conclusion and put an emphasis on the interview as an obstacle to black employment.

The most comprehensive study comes from Moss and Tilly (2001). As part of the Multi-City Study of Urban Inequality, they and their team conducted telephone surveys of over 3,500 businesses and face to face interviews of over 350 managers in Atlanta, Boston, Detroit, and Los Angeles in the early 1990s. They report that employers find blacks tend to lack in "hard skills" which can often be assessed by credentials, but more importantly, they found that there was a perception (often correct) that blacks also lagged in harder to measure "soft skills" such as attitude, motivation, professionalism, and dependability. Because of this, employers were more likely to use race, residence, or gender as a proxy for these skills.

All of these studies reveal in one way or another that a certain level of racial discrimination still exists in the American labor market. Additionally, they all tell a similar story: Employers use group characteristics as a proxy for sometimes hard to observe levels of productivity.[4] Unfortunately, these studies tell us very little about how black workers actually do get jobs. What is the mechanism at work that allows employers to overcome the problem of their limited knowledge and hire underutilized minority workers so that both can access the gain from trade? Instead, we must look elsewhere. Specifically, we find the answer in the network studies that have become popular since the work of Granovetter (1974). This very important area of research has largely been ignored by Austrian economists. In the next section, I argue that Austrian economics has much in common with network theories.

3. Network Theories and Austrian Economics

In 1985, Mark Granovetter wrote a famous article criticizing both the "undersocialized" view of action found in the economics literature and the "oversocialized" view found in the sociology literature. He argued: "Actors do not behave or decide as atoms outside a social

[4] A quick note on self-employment is in order: Theory tells us that if statistical discrimination is a problem then we should see higher levels of self-employment among blacks since they know their true productivity. Research shows that blacks actually have a lower level of self-employment than other groups (Levenstein 1995). Borjas and Bronars (1989) attribute this to consumer discrimination while Coate and Tennyson (1992) that it stems from credit market discrimination. Research by Bates (1997) shows that self-employment is highly correlated with education and personal startup capital which better explains the lower rate among blacks.

context, nor do they adhere slavishly to a script written for them by the particular intersection of social categories that they happen to occupy."

Almost 30 years earlier, Austrian economist Ludwig von Mises argued the exact same thing in his underappreciated book *Theory and History* (1957):

"The individual is born at a definite date in history into a definite situation determined by geography, history, social institutions, mores, and ideologies. He has daily to face the alteration in the structure of this traditional surrounding affected by the actions of his contemporaries. He does not simply live in the world. He lives in a circumscribed spot. He is both furthered and hampered in his acting by all that is peculiar to this spot. But he is not determined by it."

I bring this up because I believe that the Austrian school has yet to fully appreciate the implications of the fact that economic action is "embedded" in different social structures. The Austrian theory of racial discrimination developed here relies heavily on network theory to explain the persistence of labor market inequalities. Granovetter (1974) was the first to show the importance of social networks in getting a job and we can learn much from him.

The use of networks in matching prospective workers and employers arises as a result of the same Hayekian knowledge problem mentioned earlier. Not only are employers uncertain about the characteristics of applicants, they're often ignorant of the fact that some of these prospective employees exist in the first place. The same is true of employees. This can be seen as an opportunity for entrepreneurial profit. Taking advantage of their knowledge of the particular circumstances of time and place, the entrepreneur is simply alert to the opportunity for connecting labor and capital. It is not superior knowledge in the form of "human capital" (if it was then our entrepreneur would take the job himself) but rather "the 'knowledge' of where to find market data" (Kirzner 1973). This differs from Stigler's (1985) manager who decides how much to invest in the search for information. The information here is embedded in a social network which lies outside the realm of investments. As Blau (1963) points out in his discussion of "social exchange," such blatant economic investments would meet social disapproval as nobody likes the social climber or "fake" people. In this sense, our labor market entrepreneur is a "pure entrepreneur" because he does not own any factors of production, but is simply alert to profit opportunities that arose from social interactions.

One critique of this approach would find fault in my argument for the same reason they find fault in Kirzner's original argument. The critics ask: How can an entrepreneur who owns no capital contribute to the allocation of resources (Greaves 1974; Rothbard 1974)? Since he owns no resources, Kirzner's pure entrepreneur cannot make any monetary losses; therefore he is only a manager. I argue that this is too narrow a definition of profit and loss. As Mises (1949) argues, all profits are ultimately psychic profits. While the price signal is the primary mechanism for coordination in a market economy, it is not the only way. In much the same way that physical capital can bring monetary profit, so called "social capital" can bring psychic profit. This is a position taken by Chamlee-Wright and Myers (2008) who argue "nonmonetary social exchange can generate and build upon mechanisms similar to market prices, at least similar enough to generate some of the benefits of social learning."

I am not arguing that social capital is capital in the praxeological sense. Quite the contrary, I am arguing that a pure entrepreneur connecting employers and employees in a social network needs to own absolutely no physical capital, but they nonetheless make a very real psychic profit or loss depending on how the relationship between the two actors they have connected works out. This brings of the problem of the distinction between alertness and action. Some Austrians have been critical of Kirzner for his emphasis on knowledge rather than action

(Salerno 1993). Rothbard (1985) remarked "Entrepreneurial ideas without money are mere parlor games until the money is obtained and committed to the projects." While I disagree on the need for capital, I will add that alertness to opportunities without action is mere parlor games. In our case, the entrepreneur must act on their knowledge in order for it to make a difference in the real world. Knowledge and action are equal in importance.

For example, a woman may host a party at her house which is attended by many people, among them a student fresh out of college and a businessman looking to take on additional employees. The student and the businessman do not know each other and may not interact at the party. Our host, having special knowledge of the student and the businessman and being alert to the opportunity for coordination, introduces them to each other and mentions their common employment interests. Not only does she remove their ignorance of each other, but since she knows both personally, she can "vouch" for them and fill any information gaps. She has done this without the use of capital and will receive a psychic profit if the relationship works out and her friends are thankful, but may still receive a psychic loss if the student turns out to be lazy or the businessman is a harsh employer.

Network theorists have come up with similar ideas independent of Austrian influences which are useful in our discussion. Burt (1992) comes closest to the Kirznerian concept of entrepreneurship in his discussion of "structural holes." He defines a structural hole as "entrepreneurial opportunities for information access [receiving a valuable piece of information and knowing who could use it], timing [getting the information earlier than average], referrals [because you can't be everywhere at once to advocate for yourself], and control." In the case of social networks, it is a gap between nonredundant contacts filled by the entrepreneur. The main thrust of the literature on networks frames them as a mechanism for information arbitrage.

Since Granovetter (1974), numerous network theories have been developed in relation to labor markets (Marsden and Gordon 2001; Finneran and Kelly 2003; Krauth 2003; Ioannides and Loury 2004) and empirical studies show their importance time and again (Blau 1992; Blau and Robins 1992; Bewley 1999; Yakubovich 2005).

I want to make an important distinction here though because not all networks look the same. Max Weber (1968) broke down social relationships into two broad categories: communal and associative. "A social relationship will be called 'communal' if and so far as the orientation of social action – whether in the individual case, on the average, or in the pure type – is based on a subjective feeling of the parties, whether affectual or traditional, that they belong together." argued Weber while "A social relationship will be called 'associative' if and insofar as the orientation of social action within it rests on a rationally motivated adjustment of interests or a similarly motivated agreement, whether the basis of rational judgment be absolute values or reasons of expediency." There is a class element unrecognized by Weber where we see communal relationships much more common among working class individuals while associative relationships among middle and upper class individuals.

Conducting a series of in depth interviews on friendship, Walker (1996) found that working class friendships originated in the neighborhood and take place within the social context of the local bar, a neighborhood street, or the park playground. I would characterize these relationships as communal as they originate from a physical community. Middle class friendships, on the other hand, were made in college, graduate school, work, or through extracurricular activities and friends rarely come from the same neighborhood. I would characterize these relationships as associative since they originate in organizations with a common purpose.

Granovetter (1974), Burt (1992), Saxenien (1996), and most other major network studies focus on middle class and professional networks. This can be useful in some respects. For example, one study by Peterson, Saporta, and Seidal (2000) examined over 35,000 applicants over a ten year period at a midsized high-tech firm and found that all racial disparities in each stage of the hiring process disappeared once referral methods were taken into account. In these cases though, most of the individuals network with the purpose of making jobs contacts in mind. The primary *raison d'être* of these contacts is what Weber characterized as economic or at least economically oriented. They became friends because they both went to law school or because they both worked for a biotechnology firm at some point.

Unlike these associative relationships, working class networks tend not to be economic or even economically oriented. They became friends because they grew up in the same neighborhood or because their kids play baseball together, but there are still unintended economic consequences. So while it seems proper to talk about the "optimal strategy" in professional networks, this seems wholly unrealistic for working class networks.

The literature on race, networks, and work has been especially fruitful. One of the most popular methods is the use of data collected from the National Longitudinal Survey of Youth (NLSY) and the Current Population Survey (CPS). Holzer (1987), using NLSY data, found that 87-90% of the differences in employment probability of black and white youths were the result of informal networking (where blacks lacked the right connections) and direct application without referral (where statistical discrimination is more likely). Additionally, he found "virtually all of this reflects differences in the ability of these methods to produce job offers, as opposed to differences in methods used or job acceptance rates." Bortnick and Ports (1992), using data from the CPS, found that 15% of blacks who were unemployed in a given month in 1991 and who used informal contacts for their search in that month found jobs, compared to 24% of whites." Korenmen and Turner (1996), using newer NLSY data, found that minority-white wage disparities can't be explained by a lack of contacts, but rather by lower returns to contacts among blacks and Hispanics.

Other methods have included case studies of specific organizations or industries. Kasinitz and Rosenberg (1996) discovered that blacks in the Red Hook section of Brooklyn could not obtain spatially close waterfront jobs because most of the jobs were controlled by white unions outside of their social networks. Royster (2003) followed 50 black and white vocational school students in their post-high school job searches and attributes racial differences in outcomes to student connections to social networks. Similar to Kasinitz and Rosenberg, Fernandez and Fernandez-Mateo (2006) look at multiple stages in the hiring process at a manufacturing plant where more than 50% of the workforce is minority. They find some network effects though none negative on minority workers. It seems as if networks have a tendency to reproduce the characteristics of the current workforce. Waldinger (1996) looks at ethnic niches in New York City and comes to the conclusion that ethnic minorities fare better than blacks because of access to these ethnic networks.

Network theorists writing about race often have mixed normative feelings about the role of social networks. Royster (2003), for example, says that social networks "help an individual accomplish a variety of goals, including getting a job. This approach brings to my mind the workings of a 'visible hand' that interferes with the workings of the 'invisible hand' and disrupts meritocratic sorting procedures." This view gets it backwards. Royster makes the mistake of believing that, absent networks, employers would pick solely on merit. Again as Hayek points out, the knowledge problem is the central problem in economics. Rather than being a hindrance, social networks play a positive role in closing information gaps and fostering the discovery process.

4. Conclusion and Further Research Opportunities

It is my hope that this survey has shown the similarities between recent empirical work on race, knowledge, and social networks and my proposed Austrian theory of discrimination. We can draw several implications here.

The first is that unlike racial discrimination based on tastes, discrimination based on knowledge problems is much harder to combat. The combination of market forces[5] and the Civil Rights movement successfully changed America's view of racism and largely eliminated taste-based discrimination from competitive labor markets. Given the centrality of man's limited knowledge to Austrian theories (Hayek 1948), the kind of discrimination focused upon in this paper will be much harder to eliminate. This does not imply any sort of market failure though. The role of entrepreneurs in moving the market toward equilibrium applies to racial discrimination. Each case of knowledge-based discrimination simply means an opportunity for entrepreneurial profit (at least in the psychic sense).

By examining the concrete role of networks in overcoming racial discrimination, I hope I have avoided the stereotypical free market economist response that "the market will take care of it." A further understanding of some aspects of the processes that lead to the formation of social networks is still needed in order to fully understand the persistence of racial disparities. I suggest three area of study for students of the Austrian school that should contribute to the debate.

The first is the role of segregation. Becker (1957) argued that a taste for discrimination would lead to, at worst, spatial segregation. Most people today assume that current levels of segregation are the result of both black and white preferences for living near people with similar backgrounds. This is not necessarily so. Massey and Denton (1993) put the spotlight back on segregation in *American Apartheid*. In the book, they show that spatial segregation has a plethora of negative effects which spillover into market outcomes. The new attention brought by the book has sparked numerous interesting studies (Culter and Glaeser 1997; Reingold 1999; Elliot 1999; Charles 2003) and the insights of the Austrian school should not be left out of the discussion.

The second area is the effects of affirmative action. Many market-oriented economists doubt the effectiveness of most affirmative action programs because they often originate with government mandates (Epstein 1992; Sowell 2004). If my analysis is correct though, a well designed affirmative action program could have positive effects on bridging knowledge gaps and connecting blacks and whites into each other's social networks. Research by Holzer and Neumark (1999) suggests blacks hired under affirmative action policies are not wholly unqualified as measured by credentials. Unfortunately, they make no distinction between private programs and ones instituted under government pressure and do not examine the implications for social networks. Even if such a program has limited success, it might be worth exploring the secondary effects of plugging black workers into white networks as this creates more opportunities for information arbitrage.

The last area in desperate need of examination is the relationship between blacks and labor unions. While the historical literature has had a lively debate on the subject (Abbott 1993; Moreno 2006), there is next to nothing in the contemporary literature. Doeringer and Piore (1971) passively mention the idea that rigid union work rules can stunt experimentation with black workers in new roles. Additionally, unions tend to be very closed network systems

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[5] For a very interesting example of the Austrian theory of entrepreneurship actually changing people's taste for discrimination, see Coyne, Isaac, and Schwartz (forthcoming).

inaccessible to outsiders. Some recent research suggests that union presence still has negative consequences for black workers (Kasinitz and Rosenberg 1996; Agesa and Brown 1998; Heywood and Peoples 1998; Moss and Tilly 2001). Unfortunately, the labor movement still has trouble coming to grips with its race problems, whether past or present. Whether labor scholars are letting their sympathies get in the way or are just overlooking this problem by accident, it is still a subject wide open to analysis.

The Austrian school has much to contribute in the area of race and ethnic relations. It is my hope that the theories developed here contribute in some small way to that debate and discussion.

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