The human side of employment discrimination

In our company, women and minorities earn one-fifth less than other similarly situated employees. Is this pay gap discriminatory?

Employment attorneys who routinely investigate such questions know the answer to this simple question is never simple. The answer often hinges on how the attorney and their experts account for the unique attributes each employee brings to the job and the complex relationship between those attributes and the employees' ultimate salary.

Inaccurately accounting for the employees' unique job related abilities – which labor economists collectively refer to as human capital – can create unreliable statistical models of the employer's compensation system. Faulty compensation models can lead the employment attorney to mistakenly believe there is discrimination when, in fact, it does not exist.

Why are people paid differently for the same job?

Similarly, it can mask discrimination when it does exist. This article discusses the human capital factors employment attorneys need to know about when investigating salary discrimination allegations. We begin the article with a general discussion of the effect human capital has on an employee's salary. In the following sections, we discuss how courts have weighed human capital factors in their decisions regarding statistical evidence of employment discrimination. We also discuss the specific information employment attorneys need to obtain from the employer's human resource personnel when investigating the salary allegations.

Different people often earn different salaries for the same job Think of a middle level manager at your client's company. At the company, there are 100 similarly situated managers. Would it surprise you to learn each of the 100 individuals, even if they all started at exactly the same time, had different salaries? Probably not.

Why? Because even a cursory examination of the employer's compensation structure would quickly reveal that there are a myriad of employment factors influencing an individual's salary that have nothing to do with the employee's age, race, gender, or nationality. These factors must all be accounted for before a valid statistical inference can be made regarding any observed pay disparities.

Defining human capital

One of the most important determinants of a person's salary is human capital. Loosely stated, human capital is defined as the knowledge, skills, and unique abilities an employee brings to a job. Human capital investments include things such as an employee's formal education,

job training, and overall labor market experience. Investments in human capital are often compared to the physical capital investments that are made by a company. For example, an employee's decision to go back to school or get additional job training can be compared to a firm making the decision to acquire new physical capital, such as building a new factory.

Similar to an employee, a company acquires new physical capital if it will ultimately increase the company's overall profitability. In other words, the company will make the investment in additional physical capital if it believes that it can earn an adequate return on investment that improves the company's bottom line.

Employees make similar decisions when deciding to acquire additional human capital investments. Like a company, employees will acquire additional human capital if they believe the additional education or training will make them more valuable both in the labor market and with their employer. The additional value these investments add to the 'employee's bottom line' is the return on human capital.

Unfortunately, human capital investments, and the return on those investments, are much harder to quantify than physical capital investments made by companies. Differing levels of human capital, such as the person's education, experience, and job training, are the overwhelming reason why employees are paid differently in the workplace. The information the employment attorney collects from the employer forms the basis for measuring each employee's stock of human capital. Needless to say, the accuracy and thoroughness of the human capital measures collected by the employment attorney during the course of a lawsuit is critically important.

Accurate measurement of human capital investments is crucial Both conventional labor market wisdom and economic research strongly suggest human capital factors play a significant role in determining what an employee is paid. On average, human capital factors explain 75% of employee salary variation within a given job. This is true for determining why employees with different positions earn different salaries, as well as for understanding why employees with the same position earn different salaries.

A salary pie

As an illustration, think of all the factors that determine a person's salary as a pie and let's call it a 'salary pie.' The salary determination factors that go into the construction of the salary pie would include the human capital factors we have discussed. Human capital can also be related to employer level factors such as the division or department the employee works. For instance, the workplace culture in one job location may give lower level employees a greater level of responsibility and decision making power than other locations within the same firm.

Human capital, or what the employee 'brings to the table', can explain some salary disparities.

Three-fourths of the reasons why employees in the same positions are paid differently have to do with what the employee brings to the table. What accounts for the other 25%? In addition to human capital factors, the second class of factors, which accounts for about 20% of an employee's salary variation, is economic in nature.

These include factors such as the cost of living in the geographic location in which the employee works. It is not uncommon for employers with multiple locations to pay different wages to employees in order to stay competitive in the different labor markets.
For some employers, the remaining approximate 5% of an employee's salary variation within a given job can be quite nettlesome. This 5% can sometimes reflect some truly demographic neutral factors. In other instances, it may be reflective of a disparate pay system within that particular employer.

This last 5% of salary variation is particularly troubling for employers with jobs whose success depends on difficult to measure employee characteristics. In sum, while the percentages vary across employers, human

capital is typically a very important salary determinant. Inaccurately modeling an employee's human capital can cause employment attorneys to wrongly attribute (or fail to attribute), legitimate differences in salary to an individual's age, race, gender, or nationality. The courts view on human capital For some time, courts have placed significant importance on human capital factors when weighing statistical evidence in salary discrimination cases.

One particularly insightful recent case is Cooper Michaels et al. v. Southern Company, Georgia Power Company, a race discrimination class action suit. In this case, African-American workers alleged Georgia Southern discriminated against them in terms of pay and promotions.

The district court, which denied the plaintiffs' motion for class certification, was clear about the problems they found with the plaintiffs' statistical expert's model. The district court was especially clear on the issue of human capital and the failure to adequately account for it in the statistical model. In its denial of the plaintiffs' motion for class certification, the district court observed that while the plaintiffs' expert statistician did have some measures for the individual's education, they were inadequate and unconvincing.

The court was particularly taken by the fact the quality of the educational institutions was not accounted for by the plaintiffs' statistician. The court said, As the district court observed, [the plaintiffs' expert]'s reports did not take into account the type or level of acquired skills of job applicants. [The plaintiffs' expert]'s "education" component failed to take into account the field of study, the relevance of that field to any position in question, or the quality of the educational institutions involved, factors which may be important in some managers' employment decisions.

In addition to the problems with the plaintiffs' statistician's education measures, the court also took issue with other human capital factors, such as their attempts to measure job specific experience. At the end, because of the expert's lack of proper factors taken into consideration, the court ruled that the expert's reports were unreliable.

Bottom line: Courts have recognized that human capital is one reason why different people get paid differently to do the same job. Getting accurate measures of an employee's stock of human capital.

How to improve the quality of your statistical analysis

Study the employees' job descriptions.

The employee job description gives an idea of the factors the employer views as relevant to the salary determination process.

Do plant and employer tours.

Observing what the employees actually do on a day-to-day basis may provide insights into other factors that could be important to the salary determination process.

Interview human resource personnel.

Learning about the trends in hiring as well as the difficulty in hiring employees can be useful.

Look for salary outliers in the employer's workforce.

For some employers, a salary analysis can be skewed by the outcomes of only a handful of protected class members. When these people are identified, look for protected class neutral factors to explain the salaries.

Questions or comments

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