

Allied by Surprise? The Economic Case For an Anti-Discrimination Statute

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A. Introduction

The *Bundestag's* 1998-2002 term witnessed an unprecedented agenda in private law legislation. Besides profound changes in various areas, including a radical overhaul of the German Law of Civil Procedure, the German *Bundestag* (parliament) enacted a sweeping reform of the *Bürgerliches Gesetzbuch* (German Civil Code). Compared to these radical changes the proposed Act to Prevent Discrimination in Private Law seemed a rather modest endeavor.¹ The project nonetheless turned out to be more troublesome than expected. In May 2002, it was shelved, due also to heavy lobbying activities by, *inter alia*, the Catholic and Protestant Churches.² Yet it will no doubt soon re-enter the stage as Germany is under an obligation to translate two EU anti-discrimination directives into national law.³

Even though the two EU directives call for legislative action, they do not preempt the debate on the general merits and on the drafting of the provisions to be included in the German Civil Code: In general private law (as opposed to labor law) the directives only require protection against discrimination based on race and

¹ Cf. FEDERAL MINISTRY OF JUSTICE, Discussion Draft of an Act to Prevent Discriminations in Private Law (*Diskussionsentwurf eines Gesetzes zur Verhinderung von Diskriminierungen im Zivilrecht*), available at <http://www.bmj.bund.de/images/11312.pdf> (in German). But see NEUNER, JZ 2003, 57 at 57, contending that the proposed provisions were "at least as significant as the reform of the law of obligations." See the contributions by BAER, MAHLMANN and NICKEL in *Annual of German & European Law* (Russell Miller/Peer Zumbansen eds., Berghahn Books, 2003, forthcoming); see also the debate in 3 *German Law Journal* (2002) with contributions by VENNEMANN, LADEUR and WINKLER, available at <http://www.germanlawjournal.com>. Recently, BRIGITTE ZYPRIES, the newly appointed Federal Minister of Justice, indicated that the discussion draft's ambitious scope will be cut back and the German legislature might confine itself to a mere translation of the relevant EU directives (see n. 3), cf. *Frankfurter Allgemeine Zeitung* of March 8, 2003.

² Cf. *Süddeutsche Zeitung* of April 9, 2002, p. 11, and of May 22, 2002, p. 11, noting that enactment has been prevented by the Churches as well as the housing and insurance industries.

³ See Council Directive 2000/43/EC of June 29, 2000, and Council Directive 2000/78/EC of November 27, 2000.

ethnic origin.⁴ By contrast, the government's bill includes quite a few other characteristics, namely sex, religion or ideology, disability, age, and sexual orientation.⁵ Not least because of its breadth, the bill has sparked heated academic debate. While some saw the proposal as long overdue,⁶ others were appalled by what they perceived as a wide-ranging assault on the freedom of contract.⁷ Critics went so far as to link it to a totalitarian "republic of virtue" of a Jacobin breed.⁸

In this article, I will try to contribute to this debate, but not by adding one more pronounced statement. Instead, I will suggest that the legal analysis of private law discrimination can benefit from an economic point of view. Therefore, this article undertakes to present several arguments derived from an economic analysis of discrimination. Most of these arguments are based on the conventional wisdom recognized among economists; others are more controversial and reflect my own notion of what might be reasonable. As indicated by this disclaimer, I do not mean to offer economic insights in the sense of ultimate results. Economists tend to disagree at least as much as lawyers do. Economic analysis, therefore, cannot and is not meant to substitute for political or legal value judgments.⁹ What economics can do is to clarify the issues.

Some of those clarifications will come as a surprise to both camps; most people probably see anti-discrimination policy as a project of the political left.¹⁰ Economic

⁴ See Art. 1 of Directive 2000/43/EC as opposed to Art. 1 of Directive 2000/78/EC.

⁵ See the proposed sec. 319a para. 1 of the Civil Code, according to the draft (n. 1). For an overview of the bill and its background in European law see MAHLMANN, Legal parameters of European Anti-Discrimination Law, in Annual of German & European Law (Russell Miller/Peer Zumbansen eds., Berghahn Books, 2003, forthcoming).

⁶ See NICKEL, NJW 2001, 2668 at 2672. See also NICKEL, *Gleichheit und Differenz in der vielfältigen Republik* (1999) at 154-5 *and passim*; BAER, ZRP 2002, 290; VENNEMANN, Germ. L. J. 3 (2002), issue 3 at § 23; WINKLER, Germ. L. J. 3 (2002), issue 6. Cf. also BEZZENBERGER, AcP 196 (1996), 395 at 410-2 (1996), deriving a ban on ethnical discrimination from Kant's Categorical Imperative.

⁷ See ADOMEIT, NJW 2002, 1622 at 1622-3; LADEUR, Germ. L. J. 3 (2002), issue 5; PICKER, JZ 2003, 540; and the references cited in note 8. For a more balanced assessment and critique of the draft see WIEDEMANN/THÜSING, DB 2002, 463 and NEUNER, JZ 2003, 57.

⁸ See SÄCKER, ZRP 2002, 286 at 289: "Robespierre would have liked this statute." See also BRAUN, JuS 2002, 424 (in a fictitious dialogue).

⁹ Even R. POSNER, perhaps the most eminent proponent of efficiency-minded law and economics, concedes that there is more to justice and the law than just efficiency, see R. POSNER, *Economic Analysis of Law* (2003) at 27-8. The standard reference in the German legal literature is EIDENMÜLLER, *Effizienz als Rechtsprinzip* (1995).

¹⁰ The arguments used by the two sides support this classification though it is of course greatly simplified. See the references in n. 6, 7, and 8.

analysis, on the other hand, is frequently located on the right wing of the political spectrum.¹¹ This simple assignment seems to work well as both economists and conservatives – (neo-)liberals in Continental European terminology – tend to favor free markets and, consequently, the freedom to choose with whom they will deal.¹² However, these familiar lines will be upset if it turns out that, as I am going to argue, there is an economic case for anti-discrimination legislation.¹³

In what follows, two questions will be considered in turn. Firstly, an economic approach should come up with a positive theory of why there is discrimination at all (B.). Secondly, economics may also provide a normative analysis (C.). A third section contains a brief summary and concluding remarks.

B. Why Do People Discriminate – An Economic Approach

Discriminatory behavior in the private dealings of citizens is prone to draw moral disapproval. At the same time, opponents of anti-discrimination policies often denounce them as a populist fad thriving only on the hypocrisies of political correctness.¹⁴ To escape this kind of criticism one should be careful to study the conduct and motives that one wishes to abolish. Without an honest inquiry into why people discriminate a policy directed against discrimination may well turn into an empty sermon delivered by a high-minded government.

Economists have identified three different reasons for discriminatory behavior: People might discriminate against a group because they dislike the group (I.); they may think that members of the group, on average, do not make good partners for a contract (II.); or they take an interest in excluding the group from competition (III.). Before digging deeper, we should provide a definition of discrimination. Roughly in line with the bill and the EU directives, I define discrimination as any treatment by a private party that is less favorable to another person – including a refusal to deal – and is conditioned on a characteristic such as race, ethnic origin, sex etc.¹⁵

¹¹ See R. POSNER, *Economic Analysis of Law* (2003) at 27.

¹² For an economist's disapproval of anti-discrimination legislation on grounds similar to those of the German critics see FRIEDMAN, *Capitalism and Freedom* (1962) at 113. FRIEDMAN even went to the extreme of finding a similarity "in principle" between anti-discrimination laws and the Nazi regime's Nuremberg laws.

¹³ It has never been accurate to associate economics (or "law and economics") with the view that "markets fix everything", as does BAER, ZRP 2002, 290 at 292-3, mistakenly citing R. POSNER.

¹⁴ See SÄCKER, ZRP 2002, 286 at 289; LADEUR, *Germ. L. J.* 3 (2002), issue 5 at § 9.

Note that, by contrast to ordinary usage, the concept of discrimination thus defined does not carry a moral judgment: picking a spouse of opposite sex is “discriminatory” under the definition but hardly objectionable on moral grounds.¹⁶

I. A Taste for Discrimination?

For those familiar with microeconomic analysis, the most natural way to think of discrimination is in terms of preferences. When, for instance, a landlord declines to lease to a person of different ethnic origin it is straightforward to assume that, simply, she does not like to associate with foreigners or non-similar people and has a “taste” for dealing with people of her own ethnic group. Thus, under a *taste theory*, discrimination occurs when sufficiently many people have a taste for it.¹⁷

Though assuming a taste for discrimination is perhaps the first idea that comes to mind it is not necessarily the best. For one thing, it is not a very interesting theory: it mainly assumes discrimination instead of explaining it.¹⁸ More importantly, *taste theory* does not match well with reality. There is a strong argument that taste-based discrimination is driven down by market forces: suppose that all landlords have a taste for discrimination against foreigners. As a consequence, a foreign tenant would need to compensate the landlord for the “displeasure” of dealing with a foreigner. Foreigners thus pay higher rents in the housing market. By the same token, it becomes highly profitable for a landlord with discriminatory tastes to sell her property to a person with no taste for discrimination. The buyer accepts foreigners as tenants and obtains higher rents without suffering the “displeasure.” Property sales will take place up to the point where there are enough landlords without discriminatory preferences to provide sufficient housing for all foreigners.

¹⁵ Cf. the proposed sec. 319b para. 1 of the Civil Code, according to the draft (n. 1), and art. 2 para. 2 lit. a of the Council Directives 2000/78/EC and 2000/43/EC. See also the broad discussion of definitional issues in SCHWAB, *Employment Discrimination*, in: BOUCKAERT/DE GEEST, *Encyclopedia of Law and Economics* (2000) at 572.

¹⁶ For the various attempts at defining “discrimination” see HASNAS, *Equal Opportunity, Affirmative Action, and the Anti-Discrimination Principle: The Philosophical Basis for the Legal Prohibition of Discrimination*, George Mason Law and Economics Working Paper 02-28, available at <http://papers.ssrn.com>.

¹⁷ The seminal reference is BECKER, *The Economics of Discrimination* (2 ed 1973), originally published in 1957.

¹⁸ A more interesting account would specify under which circumstances discriminatory patterns emerge. Also, taste theory is not very interesting for normative economic analysis, which I am going to undertake in the second section (II.): If discrimination is just a taste then it is always efficient because the discriminator “pays” for it by foregoing profitable trading opportunities with those persons against which she discriminates, see R. POSNER, *Penn. L. Rev.* 136 (1987), 513 at 515-6.

At that point, the rent to be paid by foreigners would equal that paid by natives; discrimination would have disappeared.¹⁹

While this is certainly a stylized story it conveys an important truth: discriminatory preferences are costly foibles. People indulging in them will tend to avoid situations in which those costs occur. Systematic discrimination on a large scale is therefore unlikely to persist under a *taste theory* of discrimination. Wherever we in fact observe lasting patterns of discrimination *taste theory* does not fit well as an explanation for them.²⁰ Housing is one example. Even more striking is the insurance market. It is hard to imagine that insurance companies – out of a taste for discrimination – charge higher premiums to young females (health insurance) or young males (liability insurance). If they did, competitors would happily accommodate the discriminated group.

II. Statistical Discrimination

Because *taste theory* does not seem a good predictor of discrimination in real life, I confine myself to the following two more recent theories. The first one has come to be known as *statistical discrimination*.²¹ Generally, to get beyond *taste theory*, discriminatory behavior must be analyzed not as an end in itself but as a means of achieving an end, such as making a profit or avoiding a loss (financial or other). I have already cited insurance markets as an example. The behavior of insurance companies suggests why people might discriminate even though they have no intrinsic preference for it: if – little surprisingly – young females in their twenties turn out to cause higher costs for health care or – perhaps somewhat more surprisingly – males tend to produce considerably more accident liabilities, then an insurer is well advised to “discriminate” against females (or males) by charging them different premiums. If it does not, a competitor will win over the better risks and leave the non-discriminatory insurer with the bad risks. Whether they like it or not, insurers are forced by the market to discriminate.

Discrimination in insurance premiums is paradigmatic of *statistical discrimination*. The basic principle is simple: a person has a certain trait, propensity, or disposition

¹⁹ See R. POSNER, *The Economics of Justice* (2 ed 1983) at 352-3 and SCHWAB, *Employment Discrimination*, in: BOUCKAERT/DE GEEST, *Encyclopedia of Law and Economics* (2000) at 572. A similar argument – though not in economic terms – is made by ADOMEIT, *NJW* 2002, 1622 at 1623.

²⁰ For a more detailed discussion see SCHWAB, *Employment Discrimination*, in: BOUCKAERT/DE GEEST, *Encyclopedia of Law and Economics* (2000) at 572.

²¹ The standard references include PHELPS, *Am. Econ. Rev.* 62 (1972), 659 and ARROW, *The Theory of Discrimination*, in: ASHENFELTER/REES, *Discrimination in Labor Markets* (1973) at 23 *et seq.*

that matters (economically) for the other party to the contract because it can cause some extra cost (for example, the propensity of causing an accident). To simplify the presentation of this form of discrimination, I will adopt the perspective of the other party calling the trait “bad” (“good”) if it causes (avoids) extra costs. Suppose it is hard or impossible to observe whether a person’s trait is good or bad. However, the trait is correlated with another, apparent characteristic such as the person’s sex – that is, it is more probable that a person has the bad (good) trait if she/he is male (female). If other methods of determining the relevant trait are too expensive the prospective partner will use the apparent characteristic as a statistical proxy or indicator. In effect, those bearing the “bad” characteristic – *i.e.*, the characteristic indicating the bad trait – become the object of discrimination in the marketplace.²²

Statistical discrimination is a plausible story in many instances of discrimination based on features like sex, age, or ethnic origin. Justified or not, many landlords believe that ethnic origin is an indicator for how (un-)reliable a tenant is going to be with respect to prompt payment, considerate conduct, and careful handling of the property.²³ Personally, I find it plausible that leasing to female tenants gives a landlord a greater chance that her property is returned in good condition. From the point of view of a lender or other creditor, foreign nationals are more likely on average to move abroad, which makes it more difficult and expensive to collect repayment. No doubt female employees are more likely than males to quit their job as a result of their becoming mothers and housewives. There are many more examples.²⁴ Note that most of them do not presume that the “bad” trait is in any way

²² Note that statistical discrimination need not be the result of *asymmetric information*: It may well be that a person does not know the nature of her own trait. For instance, people usually do not know about their individual probability of contracting cancer. Such cases constitute a problem of *symmetric* lack of information; group characteristics such as sex or age are the best available information even for the person herself.

²³ See *Süddeutsche Zeitung* of April 14, 2002, p. V2/32, citing the head of the German Association of Trade Unions’ Service for Advice to Foreigners as saying that from time to time it was hard to distinguish whether foreigners were rejected as tenants out of racism or for other reasons such as many children, unemployment, or low income. See also Nickel, *Gleichheit und Differenz in der vielfältigen Republik* (1999) at 125-7, reporting discrimination by insurance companies based on ethnic origin prior to the enactment of a provision banning the practice in 1994 (sec. 81e of the Insurance Oversight Act). It seems unlikely to me that insurance companies would have engaged in such discrimination if they had not experienced a higher exposure.

²⁴ Criminal activity is another area with strong correlations. The link between citizenship and crime rate is notorious, *cf. Polizeiliche Kriminalstatistik 2000* (Official Crime Statistics for the Year 2000, available at www.bka.de), at 107 *et seq.* More striking is the connection between crime and sex: For all types of offenses, 76.9 % of all suspects are male. For intentional homicide and intentional physical injury, the respective shares raise to over 85 %, *ibid.*, 85.

inferior in a moral or general sense. Few people think that being a housewife is undeserving or blameworthy. Yet it is quite clear that an employer will not applaud her well-trained female employee when she quits her job on that account.

III. *Discrimination to Exclude Competition*

Statistical discrimination can explain a number of discriminatory practices. However, it can hardly capture all cases of disadvantageous treatment. Most markedly perhaps, it is a rather poor account for many historical instances of systematic discrimination.²⁵ Contemplating a policy against discrimination without taking those traumatic cases into account would miss an important point.²⁶

A comprehensive account of discrimination thus requires the identification of a complementary mechanism that at least explains the historical record of systematic discrimination. As such, I propose to think of discrimination as an attempt to ward off competition. Under this *competition theory*, discriminators do not strive to protect themselves from a costly (“bad”) trait that is correlated with the group characteristic.²⁷ Instead, they mean to constrain competition from the group against which they discriminate. For now, I will only consider the despicable version of such an exclusionary behavior. (I will argue later on that discrimination to exclude competition may also be desirable in certain cases.) The basic idea with the objectionable form of exclusionary behavior is that a majority can form a cartel in order to control the terms of trade with members of the minority group. To this end, members of the majority must agree systematically to disadvantage the minority by dealing with them on less favorable terms and by excluding them from profitable areas of economic activity. If the majority succeeds in maintaining such a cartel it can extract monopoly rents from the minority.²⁸

The competition model has been applied to explain the persistence of discrimination against blacks in the United States.²⁹ In the case of American Jim Crow discrimi-

²⁵ To see this, note that statistical discrimination is self-enforcing. There is no “need” for government intervention to sustain statistical discrimination yet in virtually all the great examples of political discrimination the majority undertook effort to enforce the discriminatory scheme.

²⁶ This is especially so in Germany where proponents of an anti-discrimination statute find strong support in art. 1 para. 1 of the Basic Law (*Grundgesetz*), which in turn is a reaction to the crimes committed by the German people against Jews, Sinti and Roma, disabled persons, gays, and lesbians, cf. WINKLER, *Germ. L. J.* 3 (2002), issue 6, § 6.

²⁷ See generally MUESER, *Discrimination*, in: EATWELL *et al.*, *The New Palgrave Dictionary of Economics* (1987) at 856, and AKERLOF, *Q. J. Econ.* 90 (1976), 599 at 608 *et seq.*

²⁸ *Id.*

mination there is evidence that (white) employers, over a long period, paid black employees wages below their true productivity.³⁰ At the same time, blacks were to a great extent excluded from working in manufacturing, which of course benefited white workers.³¹

However, building a cartel is not an easy task. There is a strong incentive for cartel members to deviate and compete against the cartel by offering better conditions to members of the minority (in secret, if necessary): True, individual cartel members benefit from the cartel. Yet each of them would be even better off if *only* the others maintained the cartel. Anti-competitive discrimination therefore only works if there is an effective enforcement mechanism to discipline cartel members. Such a mechanism may take the form of a social norm imposing informal sanctions for a violation of the cartel rules.³² In the most notorious historical examples the cartel was established and maintained through political violence – against members of both the minority and the majority – and particularly the abuse of government powers.³³ German history holds sad examples of such violent discrimination.

C. Dealing with Discrimination

Understanding the economic motives for discrimination conduces to rational law-making. It can caution philanthropic reformers against lumping together all kinds of discrimination. It might do even more. An economic analysis can help to find reasonable standards by which to judge discrimination. No doubt, it will strain the forbearance of some readers even to ask for an economic rationale of anti-discrimination laws. Dealing with discriminatory patterns in society touches on the law's fundamental values. On the constitutional level, anti-discrimination policy concerns the fundamental right of equal treatment, which in turn is rooted in human dignity as the paramount value of the legal system.³⁴ In such a sensitive area, applying the apparatus of welfare economics – specifically, the efficiency standard

²⁹ EPSTEIN, *Forbidden Grounds* (1992) at 91 *et seq.*

³⁰ See DONOHUE III, *Discrimination in Employment*, in NEWMAN, *The New Palgrave Dictionary of Economics and the Law* (1998) at 615.

³¹ *Id.*

³² See MCADAMS, *Harv. L. Rev.* 108 (1995), 1005 at 1045 *et seq.*; E. POSNER, *Law and Social Norms* (2000), at 133 *et seq.*; MUESER, *Discrimination*, in: EATWELL *et al.*, *The New Palgrave Dictionary of Economics* (1987) at 856. But see also the critique by EPSTEIN, *Harv. L. Rev.* 108 (1995), 1085 particularly at 1100-4.

³³ See again EPSTEIN, *Forbidden Grounds* (1992) at 91 *et seq.*

³⁴ See WINKLER (n. 26); BAER, *ZRP* 2002, 290 at 292.

– proceeds on uncertain methodological ground.³⁵ Efficiency must therefore be weighed carefully against other arguments. In spite of this warning, the following analysis will measure discrimination solely by its (in-)efficiency. While efficiency in its own right may not be the most important value to be considered, it lays bare the interests that must be taken into account. It is only one of many conceivable standards but even so it may be helpful as an analytical tool.

I. Efficiency of Statistical Discrimination

People discriminate for statistical reasons because they want to protect themselves from certain traits, which they suspect are associated with the group characteristic. To justify anti-discrimination legislation one could simply assert that people are poorly informed about the group against which they discriminate. In other words, it may be that people overestimate the correlation of the apparent characteristic and the hidden trait. Yet at closer inspection, this argument quickly evaporates. If the problem is one of poor information it hardly calls for enactment of a statute. The natural response to bad information is to provide better information. If people discriminate for statistical reasons they themselves suffer from mistaken judgment; they have no reason to disregard new information from a reliable third party (such as the government). Legal intervention therefore only makes sense when discrimination ought to be prevented *even if* it is based on an accurate statistical assessment.

1. Statistical Discrimination and Adverse Selection

At first sight, statistical discrimination – apart from misguided prejudice – seems to be an efficient *screening* mechanism. The concept of “screening” derives from the analysis of asymmetric information.³⁶ The key concern for this strand of literature is a (partial) breakdown of the market brought about by *adverse selection*.³⁷ To resume the landlord-tenant example, suppose there is a form of statistical discrimination that can sort out reliable tenants better (whereby “reliable” and “better” refers to the landlord’s point of view). Not using statistical discrimination then increases the probability of leasing high-quality apartments to unreliable tenants. This risk may drive some landlords out of the market, thereby taking out part of the high-quality supply. The remaining landlords will need to raise rents to cover the cost of more damage to the property, payment defaults, dealing with quarrels between tenants, *etc.* Higher rents may deter some of the more reliable tenants so that the mix of reliable and unreliable tenants deteriorates further. Ultimately, less high-

³⁵ See EIDENMÜLLER (n. 9), particularly at 207 *et seq.*

³⁶ But see n. 22.

³⁷ See the seminal article on the “lemon market” by AKERLOF, Q. J. *Econ.* 84 (1970) 488.

quality apartments will be offered at higher prices and a number of beneficial transactions will be foregone.

There are many more plausible examples in the same vein, all of which end with the same morale: asymmetric information encourages individuals who know they have the bad trait to enter into contracts with uninformed counterparts. Hence, trading on the market becomes more attractive for bad-type “sellers”, less attractive for “buyers”, and – after buyers adapt – also less attractive for good-type sellers. As a result, mutually beneficial trades are lost.

Restraining adverse selection makes a strong argument in favor of *statistical discrimination*. True, *statistical discrimination* not only affects those with the relevant trait: Suppose it is true that a particular group on average makes less reliable tenants and that landlords refuse to offer well-kept apartments to this group. Inevitably, the refusal will affect not only bad-type tenants but also people who – while sharing the group characteristic – would in fact prove reliable. Still, there is no way to persuade landlords that one is in fact a good tenant. If there were such a way at affordable cost a good-type tenant would gladly bear the extra expenses.³⁸ It thus seems that there is no other and more efficient arrangement: The suffering of some of the good types does not outweigh the landlords’ benefit from using *statistical discrimination*.

2. Self-Fulfilling Discrimination

Hence, at first look *statistical discrimination* is an efficient mechanism to screen applicants and to diminish market failure. There is an important caveat though: we have not yet fully appreciated how much society would gain if landlords abstained from discrimination. For one thing, good tenants sharing the group characteristic would gain access to better housing. We have said, however, that this gain does not outweigh the landlords’ loss if they were forced to abandon statistical discrimination. There is also a second gain that so far has been left unaccounted, namely that there would also be more high-quality housing offered to *unreliable* tenants. Considered independently, these contracts with “bad” tenants are inefficient because landlords are not fully compensated for the costs.³⁹ However, the overall social loss falls short of the private harm done to the individual landlord in that there is an additional benefit to unreliable tenants who, however undeservedly,

³⁸ Where “affordable” refers to the difference in valuation of renting a nice apartment *vis-à-vis* renting a not-so-nice apartment. A good tenant from the discriminated group would be willing to bear any cost below that difference so long as it credibly conveys to landlords that she is a good type.

³⁹ Otherwise, there would be no point for landlords in using statistical discrimination.

obtain better housing. For obvious reasons, landlords do not take those additional benefits into account. It follows that landlords' behavior does not necessarily reflect the social optimum. Landlords' incentives to discriminate are too strong if measured against overall social welfare. Hence, the fact that landlords use statistical discrimination does not guarantee that it is efficient.

This result – that screening cannot generally be said to be efficient – is widely acknowledged among economists.⁴⁰ At the same time, it has not gained much attention. Standard economic analysis almost exclusively focuses on the problem of *adverse selection* and, accordingly, emphasizes the efficiency advantages of screening. Economists are fond of separation technologies (such as screening).⁴¹

By contrast, the analysis of discriminatory behavior suggests a reversal of perspectives. *Statistical discrimination* aims at separating good types from bad types. Suppose, however, that people are not “good types” or “bad types” by nature. Instead, people can acquire the good trait by “investing” in it. You can try to find a good job, become well organized, pay your rent when it is due, be cautious in handling the property, comply with the norms of the neighborhood, and so forth. However, if no-one ever offers you a nice apartment, then becoming a reliable tenant is not worth the effort. Discrimination thus can become a self-fulfilling prophecy. It is not by nature or necessity that the discriminated group includes more bad types than the rest of the population. Instead, the discriminated group has more bad types *because* group members on most occasions do not get a fair chance of being treated as good types; it simply does not pay to bother being good. Society is thus trapped in an inefficient divide.⁴²

The notion of self-fulfilling discrimination makes a powerful case for anti-discrimination policy. The argument captures the moral intuition that discrimination violates human dignity: It is profoundly unfair to deprive a person of any chance to

⁴⁰ See AKERLOF, Q. J. *Econ.* 90 (1976), 599 at 601 *et seq.* On statistical discrimination, see SCHWAB, *Am. Econ. Rev.* 76 (1986), 228. Yet even law and economics scholars sometimes seem to assume that “solving information problems” through screening, sorting, signaling, or similar designs is always efficiency-enhancing. *cf.* R. POSNER, *Penn. L. Rev.* 136 (1987), 513 at 516.

⁴¹ As an example, consider university degrees as a signal for professional capabilities. It should be clear that applying this separation technology is more efficient than hiring with no regard to formal education.

⁴² See ARROW, *The Theory of Discrimination*, in: ASHENFELTER/REES, *Discrimination in Labor Markets* (1973) at 26 *et seq.*; AKERLOF, Q. J. *Econ.* 90 (1976), 599 at 606-8; MORO/NORMAN, *A General Equilibrium Model of Statistical Discrimination*, SSRN Working Paper (2002).

prove herself faithful, reliable, competent, *etc.* Also, the argument provides an economic reason for why we should care about social “inclusion”: if we do not, we waste part of society’s productive resources. The cost to our national economy are potentially severe. To mark just one important issue, Europe urgently needs to include more women and immigrants in its labor markets in order to alleviate the burden of an aging population.⁴³ If Europe – and Germany, in particular – is to have any chance in the global “war for talent” it should hasten to banish even the slightest appearance of xenophobia.

Two important implications can be derived from this argument. First, the risk that discrimination becomes self-fulfilling is worst when it is very costly (or even impossible) for a person to change the characteristic. This is pretty much true for the various characteristics named in the government’s bill (sex, race, ethnic origin, religion, ideology, disability, age, or sexual orientation).⁴⁴ In this regard, the economic rationale captures well the focus of anti-discrimination policy on “immutable” characteristics.⁴⁵ The second implication is that discrimination (or lack of discrimination) must have an influence on the behavior of those bearing the characteristic. More precisely, whether or not a person is a “good type” must – at least in the long run and to a considerable extent – depend on her own choice (which must in turn be influenced by whether or not there is discrimination). This condition holds with respect to the above characteristics and, say, a person’s propensity to commit a criminal act: there is no reason to believe that a person’s ethnic origin prevents him from being a good citizen. By contrast, the condition does not hold with regard to the higher life expectancy of women (causing higher expected cost of life insurance coverage).⁴⁶ Charging higher insurance premiums to women therefore is unlikely to cause an inefficiency.⁴⁷

⁴³ See the most recent 10. *Koordinierte Bevölkerungsvorausberechnung* (10th Population Projection) of the *Statistisches Bundesamt* (Federal Statistical Office) at 28 *et seq.* available at http://www.destatis.de/presse/deutsch/pk/2003/Bevoelkerung_2050.pdf (in German). A press release on the report in English is available at <http://www.destatis.de/presse/englisch/pm2003/p2300022.htm>

⁴⁴ See n. 5.

⁴⁵ Cf. NEUNER, JZ 2003, 57 at 62.

⁴⁶ The reason simply is that women’s longevity is unrelated to insurance premiums. Professor SACKSOFSKY, however, in an interview with the *Süddeutsche Zeitung* of March 8, 2003, p. 27, expresses the view that the government-subsidized retirement savings accounts (“*Riester-Rente*”) violated women’s right to equal treatment (by the government) on the ground that women – because of their higher life expectancy – have to save more in order to be entitled to the same monthly pension.

⁴⁷ Nonetheless, the EU Commission apparently contemplates a new directive banning different premiums according to sex, see *Financial Times Deutschland* of June 25, 2003, at 13.

II. *The Vices and Virtues of Excluding Competition*

Statistical discrimination is not the only reason of why there is discrimination. I have argued above that another reason may be an intention to exclude competitors.

1. *Chauvinism*

When introducing the *competition theory* of discrimination I focused on the great historical examples of discrimination. These examples clearly were inefficient. By excluding a minority from certain markets a discriminating majority can extract rents from the minority. In total, however, there are fewer trades on the market; the minority's productive resources are not optimally employed.⁴⁸ Chauvinistic cartels thus are easy to judge (and condemn) from an economic point of view. On the other hand, it is doubtful whether chauvinistic cartels can persist in a competitive environment. I have said above that enforcing a cartel is difficult without using violence or government intervention.⁴⁹ Neither of the two has any relevance for a private law anti-discrimination statute. Yet this is perhaps not quite the full story. The cartel strategy indicates that it can be profitable for a majority to sustain discrimination. While I find it unlikely that discrimination can be kept up solely through self-enforcing social norms, the majority can find it in its interest to make sure that existing *statistical discrimination* persists. In this sense, the existence of *statistical discrimination* becomes somewhat more double-faced: Apart from the understandable motive of self-protection there could also be a certain reluctance to break up an equilibrium that is inefficient but highly profitable for one's own group.⁵⁰

2. *Efficient Exclusion*

So far, I have considered only cartels, which are easy to condemn on economic grounds. There are other cases in which people try to exclude others – but those cases do not fit the cartel explanation. For instance, Catholic and Protestant Churches own significant properties. What if they insist on renting only to their members?⁵¹ Then again, consider the case of a feminist bookshop. What if males are not welcome to enter? What if a gay club rejects a heterosexual guest? In these

⁴⁸ Cf. R. POSNER, *The Economics of Justice* (2 ed 1983) at 85.

⁴⁹ See the text accompanying n. 33 *supra*.

⁵⁰ MORO/NORMAN, *A General Equilibrium Model of Statistical Discrimination*, SSRN Working Paper (2002) *passim* and at 21 *et seq.*

⁵¹ Apparently, that was the main concern for the Churches to lobby against the old draft, *cf.* n. 2.

and many more cases, discriminators can hardly be said to form a cartel against the excluded individuals because they lack an essential ingredient for earning monopoly profits – market power. Instead, excluding others can be vital to build and maintain a social organization such as a church, a political association, a company, or a club. If there is competition on the level of organizations, then excluding others will not force them to accept less favorable conditions; they will just have to walk into the next shop. To sum up, the lesson is this: absent market power, exclusion enhances competition and thus efficiency.⁵²

Presumably, most people will not feel uneasy about this argument in the cases cited above. Other cases seem more troublesome. For example, when a person of foreign origin is not admitted to a pub one is reluctant to dismiss her complaint that there is another pub next door who does admit foreigners. At closer inspection, however, this case is not as troubling as one suspects. Properly understood, it involves both theories of discrimination. To see this, one has to ask why the pub owner would want to reject a foreigner. A plausible answer would point towards *statistical discrimination*: the pub owner can be anxious about the chance that the person will behave inappropriately, measured by general standards or by the pub's particular policy. Alternatively, the pub owner might fear that other guests, in applying *statistical discrimination*, draw conclusions that are unfavorable for the pub's image. (Some guests might possibly perceive the pub as "cheap.") Whatever the particular line of reasoning, it most likely involves an element of *statistical discrimination*, which is subject to the arguments made above. The case therefore cannot be dismissed only because there is competition.

D. Conclusion

I have argued that discrimination can be understood in terms of two different theories: *statistical discrimination* and, secondly, discrimination as a means to exclude competitors. Discriminating behavior can result from one or both of these reasons. As to *statistical discrimination*, there is a good economic case against discrimination if the following conditions obtain: (a) The characteristic in question must be very expensive or impossible to change, and (b) there must be a risk of self-fulfilling discrimination, *i.e.* discrimination must have a stifling effect on the group in question. With regard to discrimination as a means to exclude competitors, an anti-discrimination legislation can only be justified economically in the relatively rare cases of market power.

⁵² This is the gist of EPSTEIN, *Forbidden Grounds* (1992), particularly at 60 *et seq.*

Perhaps the most fascinating result is that there is an economic case for anti-discrimination policy in private law. Legal intervention to create equal opportunities in the marketplace can enhance economic efficiency. Of course, this does not justify the particular bill now under debate. Many questions remain open. For instance, the statute's efficiency would become more questionable if, in effect, it suppressed not only discrimination but also a refusal to deal for other reasons. Reasons for a refusal are often elusive, especially to an *ex post* judicial review, but they nonetheless have great influence on performance under the contract (think of politeness, appearance, or personal sympathy). Ruling out those considerations as "unobjective" would seriously hamper mechanisms of screening and informal enforcement. And still such collateral damage may be inevitable so as to render the statute effective.

The foregoing thoughts could not do more than to provide analytical tools for dealing with this question and the many more raised in drafting and, later on, in applying an anti-discrimination statute. Of similar importance, perhaps, is that the heavy weaponry of moral judgment is applied with due care. In the politics of discrimination, it is very easy to claim that one has been treated unfairly in that the majority may assert that it is deprived of the means to protect itself from being exploited. As we have seen, this argument may be right but it can as well be part of a cartel strategy to cement segregation to the majority's advantage. On the other hand, discrimination can be – but need not be – a minority's all too simple excuse for lack of (economic) success. As elsewhere, the law's business is to strike the balance. The theorist should not be found in either of the camps.