We use a major micro data set to investigate the influence of incentive schemes on wage discrimination against blacks. Incentive schemes which directly link earnings and productivity appear to generally raise earnings, but they increase wages of blacks proportionately more than those of whites. This reduces the residual attributable to discrimination and suggests it is easier to discriminate when earnings are based on perceptions of input (evaluations of effort) rather than on measures of output.

This article tests the claim that racial wage discrimination is less severe when workers are paid according to incentive schemes. We base this claim on the distinction between incentive and time methods of payment. Pencavel explains this difference as one of monitoring techniques. Some production technologies allow an employer to directly monitor and reward productivity by paying wages that vary with the individual worker's output. If the worker is more productive, he or she will receive higher earnings. Examples of such schemes include piece rates and production bonuses. On the other hand, when production requires many steps by separate workers, requires "team production," or involves many quality dimensions, such incentive schemes cannot be used. Instead, the firm will be forced to pay time rates (hourly or weekly wages) and monitor worker input, that is effort, as a proxy for productivity. We believe it is easier for managers to discriminate where earnings are based on perceptions of effort rather than on more objective measures of worker performance.

To illustrate this point, consider the supervisor's role. When the technology requires the monitoring of input as the basis for determining wages, the supervisor's first step is to judge the effort of each employee.
Who works hardest? If the supervisor shares an incorrect prejudice that blacks work less hard, they may “score” lower on an effort evaluation. The resulting lower wages for blacks are objectified by the evaluation scores, an evaluation that inherently leaves latitude for the prejudice of the examiner.

Compare the scenario just related to an incentive scheme. For simplicity, consider a simple piece rate in which workers are paid a fixed amount for each unit produced. At the end of the pay period the supervisor has a list of employees and the number of units they completed. Discrimination requires a fully conscious decision to treat blacks worse because they are blacks, not because of some supposed productivity defect that black workers share. As a consequence, discrimination is less likely to happen.

This is not to suggest that incentive schemes leave no latitude for discrimination. Where obvious discrimination is tolerated, it may be possible (although unlawful) to pay black workers a lower incentive rate. Slightly more subtly, it could be claimed that the units produced by blacks are not up to standard, and that the quality of output, as well as the quantity, should be included in determining earnings. Further, incentive schemes will not reduce discrimination if they take the form of segregating blacks into lower paying jobs. However, when the most obvious discrimination is not accepted, incentive schemes may make wage discrimination more difficult.

We also do not suggest that all types of incentive schemes are equally likely to reduce discrimination. We limit our focus to the use of piece rates and production bonuses in contemporary manufacturing. Because these schemes are based on more objective measures of output, they are less subject to manipulation against blacks. We explicitly ignore sharecropping and tenant farming, which were part of a system of segregation and contained debt-relations not characteristic of current industrial incentive schemes. We also ignore profit sharing and gain sharing systems in which payments are based on plant-wide rather than individual production. Typically, payments from these systems follow time-rates, and should not be expected to influence discrimination. Thus, our examination is limited to a specific period and to a specific set of incentive schemes.

We confirm that black industrial workers are more likely to have the same earnings as whites when both are paid under an incentive scheme. This stands as evidence of the existence of discrimination in the time rate sector and of the comparative difficulty of discriminating when using plans that directly reward productivity. From this point of view, it may be